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FOREIGN DIRECT INVESTMENT IN THE U.S.: JOB CREATION AND STIMULATION OF ECONOMIC LINKAGES

BY

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PROFESSIONAL REPORT

Presented to the Faculty of the Graduate School of

The University of Texas at Austin

in Partial Fulfillment

of the Requirements

for the Degree of

MASTER OF PUBLIC AFFAIRS

THE UNIVERSITY OF TEXAS AT AUSTIN

August, 1987

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To Linda, David, and the memory of my aunt,
Cecilia Brixius.

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Michael F. Crowley

The University of Texas at Austin
August, 1987

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PREFACE

At the conclusion to the Bretton Woods Agreement after World War II, international financial transactions were of relatively little significance to the U.S. economy. This is not to say that they were not important. If they had been unimportant, the U.S. would not have participated in the negotiations for the Bretton Woods Agreement. Rather, international transactions were small in the overall scope of activity taking place in the U.S. economy.

Much has changed since those halcyon days. There have been sizeable increases in both international trade and investment since World War II. Between 1963 and 1983, world exports have increased twelve-fold in value (Deardorff and Stern, 1987, p. 16). Total international direct investment has increased eight-fold between 1960 and 1981 (U.S. Dept. of Commerce, August 1984, p. 6). Most of the growth in world trade has been in manufactures, a province in which the United States has steadily lost comparative advantage in recent years, as evidenced by the contribution of imbalance in manufactures trade to the overall trade deficit of the U.S. At the same time, the rate of growth of U.S. outward direct investment flows has been steadily decreasing in recent years, accompanied by rapid growth in outflows to the U.S. from other nations, principally Europe and Japan.

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The impact and meaning of these and other changes in the U.S. and international economies to the average American remain in many ways unclear. U.S. consumers buy more imported goods than ever before. Many goods that were formerly produced in the U.S. no longer are. Many electronics products, considered "high tech," have never been produced here--even while much of the research that has led to these product developments has taken place in the U.S. VCR's are a case in point. Increasingly, the research leading up to the product innovations is occurring overseas.

While U.S. consumers and businesses alike have been purchasing more and more imported goods, a great deal of manufacturing production, formerly located here in the United States has moved overseas to take advantage of lower wage rates and production costs. The production that has remained in the U.S. has suffered against the onslaught of foreign-made goods. U.S. producers have lost substantial market share in scores of industries.

American semiconductor manufacturers have given up entire lines of production in commodity chips to Japanese producers and other lower cost producers. Consumer electronics is almost dead as a U.S. industry-- even General Electric has announced the sale of its consumer electronics business to a French multinational (Sanger, July 23, 1987, p. 1). Trading on cheap labor, foreign-made textiles have gone from 25 percent to 55 percent of the U.S. market since 1980 (Wall Street Journal, March 9, 1987 p. 1). Competition from Japanese and Korean automakers has caused the U.S. auto industry to virtually cede small car production to foreign manufacturers. Even the giant General Motors Corporation has lost substantial market share in the wake of competition from the Far East.

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While the benefits of such changes to consumers in the U.S. may be cheaper prices, the lower prices have come at no small cost in jobs. By 1990, auto-related production employment will have declined by about 360,000 jobs since its peak in 1978 (Dyer, Salter, and Webber, 1987, p. 286). The losses in textile production have come at an estimated cost of 700,000 jobs (Wall Street Journal, op. cit.). Comments Ray Marshall, Secretary of Labor during the Carter Administration, "...we are living through a period of rapid and serious deindustrialization--we are losing our manufacturing base" (Cohen and Zysman, 1987 p. 60).

Even as trade-related restructuring of the economy has been taking place, with gains for some and losses for others, foreign capital has been increasingly drawn to the U.S. In part, it only reflects the importance of growing trade imbalances. The relationship between trade and investment is really very simple. Imports of goods and services increase foreign claims on U.S. assets. In the case of merchandise trade, these assets are usually dollars, although they need not be. The foreign claims on U.S. assets are called "foreign investment."

A significant share of foreign investment is the kind in which foreign interests take a controlling interest in real estate or a U.S. business enterprise. Usually defined to be a 10 percent or greater share of ownership--a controlling interest, foreign direct investment in the U.S. (FDIUS) has veritably boomed in recent years as a wage of foreign acquisitions of U.S. businesses as well as startups of new foreign-owned businesses has taken place.

The impact of FDIUS is starting to be felt in terms of jobs, as

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a multitude of Americans find themselves both host to and in the employ of foreigners. Realizing the potential for economic development, cities and states have also found themselves participating in a mad scramble for foreign direct investment.

It is not possible to analyze any of these issues in the depth required to obtain a full understanding of their implications for the U.S. economy. Nonetheless, this author hopes the reader will gain some additional insights into the economic impacts of one manifestation of internationalization in the economy--foreign direct investment in the United States.

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Chapter 1

Some Background on Foreign Direct Investment

1.1 Historical Background

The involvement of foreign capital in the United States, is no recent event. It played a strong, perhaps pivotal role in the economic development and transformation of the U.S. from a rural society to an industrial nation. Around 1870, foreign direct investment in U.S. began to take on some significance, especially in manufacturing. In fact, European investments, both in terms of capital and technology flows, contributed heavily to rapid industrial development in the U.S. around the turn of the century (Buckley and Roberts, 1982, pp. 29-33). With the liquidation of significant stocks of foreign holdings around the time of the two world wars, the significance of such investment was largely reduced.

It was not until the early 1970s that public interest in foreign investment was next aroused in a big way, with fears that OPEC surpluses would be used to gain control of big chunks of U.S. real estate and business. The "oil crisis", induced by a cartel of largely Middle East oil-producing nations, left a handful of desert kingdoms awash in liquidity and produced images in the popular press of oil-wealthy sheiks buying up huge quantities of American assets, including U.S. farmland.

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This and concerns about yen appreciation and the significant inroads by Japanese investors in the Western U.S., especially in Hawaii, led to calls for the first U.S. government assessment of foreign investment in the mid-70s (Crowe, 1978, p. 205).

1.2 Recent Trends and Policy Issues

Considerable interest has been generated in recent years over the role of foreign direct investment (FDIUS) in the U.S. economy.[1] Much of this interest owes to the rapidly accelerating magnitude of foreign influence in the U.S. economy. Until the early 1970s, FDIUS had been somewhat erratic. Then, in 1973, FDIUS began to increase sharply for reasons that have been attributed to two devaluations of the U.S. dollar, higher unit labor costs in Europe and Japan, and a number of other reasons (Webley, 1974, p. 4).

Whatever the reasons, since 1970, the nominal value of FDIUS has increased from $13.3 billion to $209.3 billion by 1986--at an average annual compounded growth rate of 17.6 percent. And FDIUS is growing faster than U.S. investment in other countries. Until the 1970s, foreign direct investment in the U.S. has been dwarfed by U.S. investment in other countries. While U.S. outward bound investment was $75.5 billion in 1970 and had grown to $259.9 billion by 1986, it only increased at a rate of 7.5 percent on an annual compounded basis (U.S. Dept. of Commerce, August 1984, pp. 54 & 65; Wall Street

---

[1]FDIUS is the transaction, or result of a transaction, which allows a foreign national or firm to develop a lasting interest in and influence over the management and operations of a U.S. firm or business enterprise. The customary measure of foreign direct investment is a 10 percent or greater foreign ownership interest.

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Journal, June 25, 1987, p. 18). With growth rates of this kind, foreign direct investment in the U.S. will soon eclipse U.S. outward bound investment.

Another element of this interest in FDIUS concerns the increasing foreign ownership of U.S. business. In 1975, Arpan and Ricks counted 1211 foreign-owned manufacturing firms in the U.S. (Arpan and Ricks, 1975). By 1985, their estimate had increased to 5649 firms (Arpan and Ricks, 1985). From 1979 to 1985, the Commerce Department's Bureau of Economic Analysis (BEA) recorded 7,714 foreign direct investments in all industries (Shea, 1986, p. 47). Foreign-owned U.S. firms also more than doubled their employment between 1974 and 1984 at an average annual compounded growth rate of 9.9 percent, increasing from 1.1 million, or 1.6 percent of U.S. private domestic employment, to 2.7 million and 3.3 percent of U.S. employment. In many industries, this penetration by foreign-owned firms was represented by far greater percentages of U.S. industry employment. For example, in 1984, foreign-owned firms were responsible for 50 percent of employment in Petroleum and Coal Products (SIC 29), 39 percent of industry employment in Chemicals (SIC 28), 20 percent of employment in the Oil and Gas Extraction (SIC 13) industry, and 11 percent of Primary Metal Products (SIC 33). In the case of the Chemicals industry, employment penetration had only been 11 percent in 1974. This gives graphic evidence of the fact that foreign penetration of U.S. manufacturing has proceeded rapidly over the past decade.

Some of the interest generated by this increased foreign investment in U.S. industry is related to a fear of loss of control. For instance, during the 1970s, there was a great deal of concern about

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foreign ownership of agricultural land in the U.S. (Wilkins, 1986). With respect to U.S. manufacturing, much of the concern has to do with a loss of control of manufacturing production decisions in the economy, as well as major sources of employment to foreign nationals. Yet, the U.S. has almost always followed a policy of non-interference in the U.S. investment decisions of foreign firms or nationals.[2] As recently as September 1983, President Reagan released a major policy statement expressing the basic U.S. policy that international investment should respond to private market forces (U.S. Dept. of Commerce, August 1984, p. 85).

Any fear of foreign direct investment (FDIUS) in the U.S. has been generally muted by an overarching concern relating to the overall decline in U.S. manufacturing since the early 1970s. More than half of FDIUS jobs have gone to manufacturing. From 1974 to 1984, U.S. manufacturing employment contracted by 2.9 percent even as employment attributable to FDIUS in manufacturing expanded by 136 percent. In fact, after reaching a peak of 21,040,000 jobs in 1979 (Bureau of Labor Statistics, 1985) manufacturing employment has declined both in absolute terms and relative to other sectors of the economy.

Both this relative decline in U.S. manufacturing and the expansion of foreign investment in the same sector, as well as others,

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[2]There are noteworthy exceptions to this rule, often related to national security interests and the protection of basic defense-related industries. A recent example involving FCC regulations and the television broadcast industry concerned the purchase of Metromedia affiliates by the Australian Rupert Murdoch. Interestingly enough, this particular case was resolved when Murdoch obtained U.S. citizenship.

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are signs of the far-reaching internationalization of the U.S. economy which has been occurring over the past decade. In the last twenty years, "exports and imports have tripled their share of GNP and international direct investment has expanded severalfold" (Glickman and Woodward, 1986)

This internationalization of the the U.S. economy has subjected U.S. industry to intense competition from foreign manufactured goods as well as products manufactured by affiliates of foreign firms located in the U.S. This competition underscores the relationship between international trade and investment. When the U.S. purchases foreign goods and services, it pays for them with foreign assets, usually cash or other money-surrogates that can be used in turn to purchase U.S. goods or services, or to purchase interests in producing assets, such as new or existing U.S.-operating businesses. Through trade, such investments can be turned to additional strategic value for their foreign owners. For instance, a good portion of foreign direct investment has occurred in the wholesale and retail trades (altogether, 30.6 percent of FDIUS employment). This testifies to the strong marketing orientation of foreign direct investment, and another important fact about FDIUS. Foreign-owned firms import large quantities of merchandise that competes directly with U.S. produced goods. In fact, foreign-owned firms were responsible for 31 percent of all U.S. imports in 1984, and 39 percent of the U.S. merchandise trade deficit. Foreign-owned wholesale businesses, alone, were responsible for 23 percent of U.S. imports and 29 percent of the merchandise trade deficit.

Internationalization in the economy is at least in part attributable to the fact that improvements in communication,

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transportation, and fabrication processes, as well as the increased mobility of capital across international borders have favored foreign firms, who--whether they produce here or abroad--are often able to take advantage of much lower production costs than U.S. manufacturers or are willing to engage in innovative product development owing to relative product cycle youth.[3] One dramatic sign of the resulting restructuring of U.S. industry has been the spate of plant closings in recent years, following in the wake of decisions to take advantage of lower labor costs in other countries.

The rapid increase in FDIUS has broad policy-making implications for decision makers concerned with economic development and the apparent U.S. trend toward deindustrialization. Many proponents of foreign direct investment believe that it can help alleviate industrial decline and the economic restructuring of cities, states, and regions by introducing new plants, production processes, and technology into an economy that is producing more lower-wage service sector jobs than anything else. It is also believed that FDIUS can help stem loss of relatively high-wage manufacturing employment by increasing job opportunities and/or maintaining employment which would otherwise be lost without the investment. FDIUS may provide a buffer against the overall trend toward deindustrialization.

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[3]The product cycle argument would suggest that many U.S. businesses are operating as they would in a mature industry--one which is experiencing a diminished rate of growth and has entered a period of stability or decline.

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1.3 Issues and the Organization of this Report

If policy-makers are to formulate any rational policy toward FDIUS that attempts to integrate foreign direct investment into part of an overall policy for coping with regional and national industrial change, then its impact in producing jobs and creating local linkages to help stimulate economic development must be known. In this report, the role of foreign direct investment in producing jobs and economic linkages will be explored. Chapter 2 is an exploration and analysis of the job creation effects of foreign direct investment in the U.S. Chapter 3 examines the issue of economic linkages produced by foreign direct investment, emphasizing the case of manufacturing--which is important for its role in economic development. The analysis is conducted primarily through means of a single state survey of manufacturing firms in Texas. A further interest is to explore the trade-relatedness of foreign direct investment and its implications for the stimulation of jobs and economic linkages by examining a specific-industry case. Chapter 4 examines these issues for the auto industry. An additional concern lies in the arena of government policy. Chapter 5 is an exploration of explicit Federal policies toward foreign direct investment. Finally, Chapter 6 contains some concluding thoughts concerning the implications of foreign direct investment in the United States.

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Chapter 2

Foreign Direct Investment and the Prospects for Employment Creation

2.1 Introduction

"Corporate Immigrants Are Bringing Jobs, Money, and a New Way of Life" extols the cover of a recent issue of the news magazine published by the U.S. Chamber of Commerce (Nation's Business, April 1987). And, for many Americans, it is the added jobs that count most. Fuji Heavy Industries and Isuzu Motors are two such corporate immigrants--Japanese producers of Subaru and Isuzu cars and trucks. Both companies have announced plans for a joint venture to construct an auto assembly plant in Lafayette, Indiana. But rumors and job inquiries have already been pouring into the local employment office for months before the announcement (Wilkerson, 1987, p. 5). Another example of how U.S. workers feel about such jobs--the employment office in Georgetown, Kentucky already has 50,000 job applications on file for 1,400 jobs at a Toyota plant that will not even open until next year.

But, cities and states are relying on more than just a hand full of new Japanese-owned auto plants to produce jobs. Battle Creek, Michigan, has relied on Japanese and German-owned firms in recent

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years to help rebuild its recession-shattered economy and create new employment opportunities (Steinbach and Peirce, 1984, p. 818). Commenting on the 60,000 Georgians employed by foreign-owned firms in his state, Governor Joe Frank Harris says that thes companies are "replacing jobs that have been lost from [closed] American manufacturing operations." He says, "It's keeping people working and it's hard to criticize employment" (New York Times, September 16, 1985, p. 33). More than forty nationalities are represented in foreign-owned businesses in Huntsville, Alabama, and community leaders are working to attract even more immigrant business (Eason, 1987, p. 19). Countless other cities and states are globe-trotting in search of foreign direct investment with the same goal.

It is not just investments in new plants that are being counted on to provide new jobs. Often, it is hoped that foreign acquisitions of U.S. firms will have the same effect. Preserving old jobs and creating new ones has even entered into the debate over the recently-planned and now cancelled Fujitsu acquisition of Fairchild Semiconductor (Malone, 1987, p. 18).[4] Indeed, "expanded employment" opportunities heads up a list of the benefits to states of foreign direct investment prepared by Cedric Suzman (1982, p. 28) of the Southern Center for International Studies.

Job creation has long been held to be one of the paramount benefits of foreign direct investment. Says Wilkins (1979, p. 117), "The

---

[4]The Fujitsu-Fairchild linkup was scuttled after strenuous objections by elements within the Reagan Administration, most notably Commerce Secretary Malcolm Baldrige, over the loss of ownership of militarily-sensitive technology to Japan (Schlender, 1987, p. 3)

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benefits of non-U.S.[-owned] investment are similar in most respects to the benefits of any investment: increased employment, which generates new purchasing power, which stimulates added investment." A paper prepared by the Library of Congress cites one of the most important effects of foreign direct investment as being the impact on U.S. jobs (Wilson, 1983, p. 11). Zupnick's (1980, p. 49) discussion of the costs and benefits of foreign direct investment mentions the provision of "well-paid jobs for American workers," something of particular note "at a time when unemployment in some U.S. industries remains a problem." Gordon and Lees (1986, p. 218) also note the importance of the employment effects of foreign investors.

It has also been suggested that employment resulting from foreign direct investment has exerted an important influence on the economy during times of rampant recession and structural change. Little (1985, p. 48) has examined the role of foreign direct investment in New England and found foreign-owned firms to be "playing a significant part in buoying New England's employment...." She also suggests that foreign-owned firms have reduced job loss in declining industries and fostered job gains in expanding industries (Ibid, p. 57). Wilkins (Ibid, p. 118) notes that employment rose in foreign-owned firms in Florida, even during a recessionary period. Kahley (1985, p. 14) highlights the importance of job gains from foreign direct investment in the Southeast in tempering that region's bout with the 1981-82 recession. At the national level, Little (1986, p. 43) says that foreign-owned businesses may have "offset as much as 11 percent of the actual decline in manufacturing employment" between 1979 and 1983.

There can be no doubt that foreign investors have created new

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jobs in the U.S. However, many unanswered questions remain as to the extent of the direct job creation effects. For instance, while many jobs are created through construction of new plants and opening new businesses, much foreign investment is oriented to the acquisition of existing businesses--and may or may not involve increased employment. The next section will examine some of the gross direct employment impacts of foreign direct investment on an industry and regional basis in order to compare and differentiate between employment changes in foreign-owned firms and the economy at large. The section following uses a new analytical framework to suggest that the job gains attributed to foreign investors may be overstated, and worth subjecting to greater scrutiny.

2.2 Recent Employment Growth in U.S. Industries

In 1974, one out of every 63 workers in U.S. private industry[5], over one million Americans altogether, were employed by foreign-owned firms. By 1984, one out of 30 workers, or 2.7 million Americans,

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[5]The discussion on U.S. and foreign-owned firm employment in this section excludes workers in the deposit banking industry (SICs 601, 602, 603, and part of 6052, 6056, or Direct Investment Code 600, adapted from the 1974 Enterprise Standard Industrial Classification Manual), both foreign and domestic-owned, because the Bureau of Economic Analysis failed to report the data for foreign-owned firms except in their 1974 and 1980 benchmark reports. The employment data presented in the discussion in this section may also slightly underestimate the actual employment of foreign-owned firms for 1974. Coleman (1985) has prepared revised data for 1974, which suggest that the employment data used here may underrepresent actual foreign firm employment by about six percent. However, Coleman's industry detail is inferior to that presented here, and the geographic coverage of his estimates is incompatible with that presented here. The employment data used here include all geographic parts of the U.S., including Puerto Rico, and other offshore territories. Coleman's 1974 data are used in the following section, where the discussion is limited to the U.S. regions encompassing the 48 continental U.S. states.

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labored for foreign bosses. The figures might not be so startling if they did not underscore the increasing employment impact of foreign businesses in the U.S., and the comparative malaise afflicting employment growth within certain sectors of the economy over the last several years.

Between 1974 and 1984, foreign-controlled businesses increased their employment 157 percent, reflecting an average annual compounded growth rate of almost 10 percent. By contrast, over the same period, employment in U.S. private business increased only 23 percent, at a growth rate of 2.1 percent a year. Confirming Little's (1986) results, the employment growth of foreign-owned businesses was able to account for 11 percent of the at-large employment growth. This suggests that the employment impacts of foreign-owned businesses in the economy as a whole have been profound, with a far disproportionate amount of the employment gains owing to their operations.

A look at employment change across industries reveals that the employment growth resulting from foreign direct investment has not been spread evenly across industries, nor has it necessarily corresponded proportionately to those areas where the private U.S. economy is experiencing the most growth. In fact, in most industries where the U.S. economy is experiencing shrinking employment opportunities, foreign investors are adding jobs. In a couple of industries, as well, foreign investors are cutting back on employment when the economy-at-large is adding jobs. (See Tables 2-1 and 2-2.)

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Table 2-1: Industry Distribution of FDIUS Employment, 1974 and 1984

INDUSTRY (SIC)	1974 EMPLOYMENT	FDIUS SHARE	INDUSTRY SHARE	1984 EMPLOYMENT	FDIUS SHARE	INDUSTRY SHARE	FDI JOB GROWTH	GROWTH SHARE	PERCENT CHANGE	FDI GROWT RATE
AG., FORESTRY, & FISHING	7,917	0.7	0.5	9,409	0.3	0.5	1,492	0.1	18.8	1.7
MINING	33,068	3.1	4.8	52,514	1.9	5.4	19,446	1.2	58.8	4.7
METAL (10)	13,600	1.3	14.2	10,813	0.4	19.7	-2,787	-0.2	-20.5	-2.3
OIL & GAS (13)	10,330	1.0	3.4	20,088	0.7	3.3	9,758	0.6	94.5	6.9
COAL & OTHER (11, 12, 14)	9,138	0.9	3.0	21,613	0.8	7.0	12,475	0.8	136.5	9.0
CONSTRUCTION	7,672	0.7	0.2	42,217	1.6	0.9	34,545	2.1	450.3	18.6
MANUFACTURING	623,077	58.9	3.1	1,469,611	54.1	7.5	846,534	51.1	135.9	9.0
FOOD PRODS. (20)	74,721	7.1	4.4	144,507	5.3	8.9	69,786	4.2	93.4	6.8
CHEMICALS (28)	114,695	10.8	11.2	405,893	14.9	38.6	291,198	17.6	253.9	13.5
PETROLEUM PRODS. (29)	72,439	6.9	38.1	91,832	3.4	49.9	19,393	1.2	26.8	2.4
METALS (33, 34)	87,842	8.3	3.0	164,307	6.1	7.1	76,465	4.6	87.0	6.5
PRIMARY (33)	59,592	5.6	4.6	96,645	3.6	11.2	37,053	2.2	62.2	5.0
FABRICATED (34)	28,250	2.7	1.7	67,662	2.5	4.6	39,412	2.4	139.5	9.1
MACHINERY (35, 36)	99,555	9.4	2.4	308,791	11.4	7.0	209,236	12.6	210.2	12.0
NONELECTRIC (35)	43,361	4.1	1.9	127,585	4.7	5.8	84,224	5.1	194.2	11.4
ELECTRICAL (36)	56,194	5.3	2.8	181,206	6.7	8.2	125,012	7.5	222.5	12.4
OTHER MFG.	173,825	16.4	1.7	354,281	13.0	3.6	180,456	10.9	103.8	7.4
TEXTILE & APP. (22, 23)	36,831	3.5	1.6	35,130	1.3	1.8	-1,701	-0.1	-4.6	-0.5
LUMBER & WOOD (24)	4,720	0.4	0.7	5,865	0.2	0.8	1,145	0.1	24.3	2.2
FURN. & FIXTURES (25)	2,133	0.2	0.4	8,293	0.3	1.7	6,160	0.4	288.8	14.5
PAPER PRODS. (26)	13,453	1.3	1.9	41,921	1.5	6.2	28,468	1.7	211.6	12.0
PRINTING & PUBL. (27)	26,566	2.5	2.4	64,422	2.4	4.6	37,856	2.3	142.5	9.3
RUBBER & PLAST. (30)	15,202	1.4	2.2	20,725	0.8	2.6	5,523	0.3	36.3	3.1
TRANSP. EQUIP. (37)	4,981	0.5	0.3	60,978	2.2	3.2	55,997	3.4	1124.2	28.5
MOTOR VEHICLES (371)	3,552	0.3	0.4	53,175	2.0	6.2	49,623	3.0	1397.0	31.1
OTHER TRANSP.	1,429	0.1	0.1	7,803	0.3	0.7	6,374	0.4	446.0	18.5
INSTRUMENTS (38)	23,295	2.2	3.9	22,757	0.8	3.2	-538	0.0	-2.3	-0.2
MISCELLANEOUS (39)	15,856	1.5	3.5	18,654	0.7	4.7	2,798	0.2	17.6	1.6
N.E.C. (21, 31, 32)	25,807	2.4	2.5	75,536	2.8	8.8	49,729	3.0	192.7	11.3
T.P.U.	47,690	4.5	1.0	65,436	2.4	1.3	17,746	1.1	37.2	3.2
AIR TRANSPORT (45)	13,500	1.3	3.7	761	0.0	0.2	-12,739	-0.8	-94.4	-25.0
COMM. & PUB UTIL (48, 49)	585	0.1	0.0	10,262	0.4	0.5	9,677	0.6	1654.2	33.2
WHOLESALE	129,625	12.3	2.9	302,890	11.2	5.4	173,265	10.5	133.7	8.9
RETAIL	120,522	11.4	1.0	454,335	16.7	2.7	333,813	20.1	277.0	14.2
F.I.R.E.	46,630	4.4	1.6	126,266	4.7	3.0	79,636	4.8	170.8	10.5
INSURANCE (63, 64)	32,765	3.1	2.3	61,507	2.3	3.3	28,742	1.7	87.7	6.5
REAL ESTATE	5,333	0.5	0.6	26,510	1.0	2.2	21,177	1.3	397.1	17.4
SERVICES	41,052	3.9	0.3	191,564	7.1	0.8	150,512	9.1	366.6	16.7
HOTELS & LODGING (70)	13,814	1.3	1.5	35,963	1.3	2.7	22,149	1.3	160.3	10.0
TOTAL	1,057,447	100.0	1.6	2,715,318	100.0	3.3	1,657,871	100.0	156.8	9.9

NOTE: BANKING NOT INCLUDED IN F.I.R.E. OR EMPLOYMENT TOTALS.
SOURCES: U.S. DEPT. OF COMMERCE (1976, 1978, 1986).

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Table 2-2: Industry Distribution of U.S. Private Domestic Employment, 1974 and 1984

INDUSTRY (SIC)	1974 EMPLOYMENT	EMP. SHARE	1984 EMPLOYMENT	EMP. SHARE	US JOB GROWTH	GROWTH SHARE	PERCENT CHANGE	US GROWTH RATE
AG., FORESTRY, & FISHING	1,607,000	2.4	1,732,000	2.1	125,000	0.8	7.8	0.8
MINING	696,000	1.0	972,000	1.2	276,000	1.8	39.7	3.4
METAL (10)	96,000	0.1	55,000	0.1	-41,000	-0.3	-42.7	-5.4
OIL & GAS (13)	300,000	0.5	607,000	0.7	307,000	2.0	102.3	7.3
COAL & OTHER (11, 12, 14)	300,000	0.5	310,000	0.4	10,000	0.1	3.3	0.3
CONSTRUCTION	4,048,000	6.1	4,520,000	5.5	472,000	3.1	11.7	1.1
MANUFACTURING	20,069,000	30.2	19,478,000	23.8	-591,000	-3.9	-2.9	-0.3
FOOD PRODS. (20)	1,713,000	2.6	1,618,000	2.0	-95,000	-0.6	-5.5	-0.6
CHEMICALS (28)	1,026,000	1.5	1,051,000	1.3	25,000	0.2	2.4	0.2
PETROLEUM PRODS. (29)	190,000	0.3	184,000	0.2	-6,000	0.0	-3.2	-0.3
METALS (33, 34)	2,917,000	4.4	2,326,000	2.8	LE101,000	-3.9	-20.3	-2.2
PRIMARY (33)	1,286,000	1.9	863,000	1.1	-423,000	-2.8	-32.9	-3.9
FABRICATED (34)	1,631,000	2.5	1,463,000	1.8	-168,000	-1.1	-10.3	-1.1
MACHINERY (35, 36)	4,202,000	6.3	4,416,000	5.4	214,000	1.4	5.1	0.5
NONELECTRIC (35)	2,224,000	3.3	2,204,000	2.7	-20,000	-0.1	-0.9	-0.1
ELECTRICAL (36)	1,978,000	3.0	2,212,000	2.7	234,000	1.5	11.8	1.1
OTHER MFG.	10,021,000	15.1	9,883,000	12.1	-138,000	-0.9	-1.4	-0.1
TEXTILE & APP. (22, 23)	2,336,000	3.5	1,950,000	2.4	-386,000	-2.5	-16.5	-1.8
LUMBER & WOOD (24)	723,000	1.1	718,000	0.9	-5,000	0.0	-0.7	-0.1
FURN. & FIXTURES (25)	485,000	0.7	489,000	0.6	4,000	0.0	0.8	0.1
PAPER PRODS. (26)	701,000	1.1	681,000	0.8	-20,000	-0.1	-2.9	-0.3
PRINTING & PUBL. (27)	1,106,000	1.7	1,399,000	1.7	293,000	1.9	26.5	2.4
RUBBER & PLAST. (30)	704,000	1.1	785,000	1.0	81,000	0.5	11.5	1.1
TRANSP. EQUIP. (37)	1,872,000	2.8	1,898,000	2.3	26,000	0.2	1.4	0.1
MOTOR VEHICLES (371)	910,000	1.4	855,000	1.0	-55,000	-0.4	-6.0	-0.6
OTHER TRANSP.	962,000	1.4	1,043,000	1.3	81,000	0.5	8.4	0.8
INSTRUMENTS (38)	592,000	0.9	712,000	0.9	120,000	0.8	20.3	1.9
MISCELLANEOUS (39)	455,000	0.7	395,000	0.5	-60,000	-0.4	-13.2	-1.4
N.E.C. (21, 31, 32)	1,047,000	1.6	856,000	1.0	-191,000	-1.3	-18.2	-2.0
T.P.U.	4,717,000	7.1	5,194,000	6.4	477,000	3.1	10.1	1.0
AIR TRANSPORT (45)	369,000	0.6	486,000	0.6	117,000	0.8	31.7	2.8
COMM. & PUB UTIL (48, 49)	1,937,000	2.9	2,236,000	2.7	299,000	2.0	15.4	1.4
WHOLESALE	4,503,000	6.8	5,639,000	6.9	1,136,000	7.5	25.2	2.3
RETAIL	12,604,000	18.9	17,042,000	20.9	4,438,000	29.2	35.2	3.1
F.I.R.E.	2,971,000	4.5	4,259,000	5.2	1,288,000	8.5	43.4	3.7
INSURANCE (63, 64)	1,421,000	2.1	1,840,000	2.3	419,000	2.8	29.5	2.6
REAL ESTATE	870,000	1.3	1,206,000	1.5	336,000	2.2	38.6	3.3
SERVICES	15,311,000	23.0	22,899,000	28.0	7,588,000	49.9	49.6	4.1
HOTELS & LODGING (70)	919,000	1.4	1,336,000	1.6	417,000	2.7	45.4	3.8
TOTAL	66,526,000	100.0	81,735,000	100.0	15,209,000	100.0	22.9	2.1

SOURCES: U.S. DEPT. OF COMMERCE (1978, 1986).

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2.2.1 Manufacturing

Perhaps most striking is that more than half of employment resulting from foreign direct investment is located in manufacturing industries. While employment shares in manufacturing have shrunken slightly between 1974 and 1984 owing to increased growth in other industries, employment has still grown by almost 847,000 jobs. In contrast, the U.S. has witnessed a dramatic loss of employment opportunities in manufacturing over the same period--on the order of 591,000 jobs. And, manufacturing in the U.S. private economy has slipped from 30 percent of all jobs in 1974 to less than 24 percent in 1985. (See Tables 2-1 and 2-2.) By 1984, one in every 13.3 manufacturing employees worked for a foreign-controlled firm. This shifting of industry employment shares illustrates the higher importance placed by foreign investors in manufacturing than by domestic investors. While U.S. manufacturing was witnessed net shrinkage in employment, foreign direct investment in manufacturing has grown almost without regard to U.S. industry trends, increasing employment by 136 percent in ten years. However, foreign direct investors are increasingly interested in other areas of the U.S. economy, and to a greater extent than manufacturing. So, while the U.S. employment share in manufacturing has decreased owing to net employment shrinkage, a relative disinvestment process vis a vis other industries, the decreased FDIUS employment share in manufacturing is the result of more rapidly increasing investment in other industries.

One of the fastest growing areas for foreign direct investment in manufacturing was in the chemical industry. Chemicals was also one of the few areas showing net U.S. employment growth between 1974 and

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1984. The average annual compounded growth rate of employment tied to foreign direct investment was 13.5 percent, while only 0.2 percent for the U.S. industry as a whole. In 1984, Chemicals had the largest share of FDIUS manufacturing employment, with 27.6 percent of all the manufacturing jobs belonging to foreign-owned manufacturers. One in every 2.6 chemical industry workers was on the payroll of a foreign-owned firm--almost 40 percent of all chemical industry jobs.

Other areas of remarkable growth in manufacturing employment for foreign direct investors are Transportation Equipment, with an average annual compounded growth rate of 28.5 percent between 1974 and 1984, Furniture and Fixtures, with growth of 14.5 percent a year, Machinery, with 12.0 percent growth per year, and Printing and Publishing, also with 12.0 percent annual growth. For the U.S. at-large, these were industries of minimal employment growth, with employment expansion of five percent or less over the period with the exception of Printing and Publishing, which expanded employment by 26.5 percent--a greater increase than experienced by the U.S. economy as a whole.

Within manufacturing, the area showing the fastest job growth for foreign investors was Transportation Equipment. Motor Vehicles and Equipment accounted for most of the growth in Transportation Equipment with the addition of almost 50,000 jobs between 1974 and 1984, at an average annual compounded growth rate of 31.1 percent. This job growth occurred when U.S. Motor Vehicle and Equipment producers as a whole were losing 55,000 jobs. By 1984, one of every 16 workers in the Motor Vehicles and Equipment industry was on the payroll of a foreign-owned firm, compared with one in every 256 in 1974.

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Although not a fast growth industry for foreign investors, another area of particular importance in terms of jobs owed to foreign direct investors is the Petroleum (and Coal) Products industry. This is an industry showing net employment shrinkage between 1974 and 1984, and slow foreign direct investment growth. However, the growth of jobs attributable to foreign direct investors illustrates the increasing importance of foreign direct investment to the industry. Although the employment of foreign-owned firms in the industry has only grown 2.4 percent per year between 1974 and 1984, this has been enough to insure increasing and significant foreign penetration. Half of all workers in the industry owed their jobs to foreign investors in 1984--up from 38 percent in 1974.

Other areas in which foreign direct investors have obtained significant and higher than average shares of domestic manufacturing employment by 1984 are, Primary Metals (11.2 percent), Food Products (8.9 percent), and Electrical Machinery (8.2 percent).

One notable surprise is that the second leading industry for U.S. manufacturing employment growth after Printing and Publishing, Instruments (and Related Products), actually lost jobs attributable to foreign direct investors between 1974 and 1984. While employment growth within the industry as a whole was more than 20 percent, or 1.9 percent per year over the decade, FDIUS jobs decreased by 538. Another area of FDIUS job loss was Textiles and Apparel, with a 4.6 percent decrease in employment in foreign-owned firms. In this case, the industry at-large also experienced heavy and proportionately greater job loss.

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In 1984, four industry groupings accounted for 70 percent of FDIUS manufacturing employment, or 38 percent of all FDIUS employment: Chemicals (27.6 percent of manufacturing employment), Machinery (21.0 percent), Primary and Fabricated Metals (11.2 percent), and Food Products (9.8 percent). In contrast, the same industries accounted for only 48 percent of net U.S. manufacturing employment, and just 12 percent of U.S. private domestic employment.

2.2.2 Wholesale and Retail

Illustrative of the marketing orientation of foreign direct investment, perhaps, are investment in the Wholesale and Retail trades. Taken together, they accounted for 28 percent of the employment of foreign direct investors in 1984. While Wholesale lost some importance, declining from 12.3 percent to 11.2 percent of total FDIUS employment between 1974 and 1984, it nevertheless expanded employment at the rate of 8.9 percent a year, while U.S. wholesaling at-large increased only 2.3 percent a year. This enabled the FDIUS employment share of the industry to increase from 2.9 percent in 1974 to 5.4 percent in 1984. The Retail industry, on the other hand, showed even more substantial employment increases, with growth of 14.2 percent a year. This occurred while U.S. Retailing as a whole increased employment at a rate of only 3.1 percent a year. As a result, FDIUS employment penetration of the Retail industry increased from 1.0 percent to 2.7 percent between 1974 and 1984, and Retail increased its share of FDIUS employment from 11.4 to 16.7 percent.

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2.2.3 Services

Not only were Services the fastest growing division-level industry in the U.S. private economy between 1974 and 1984, they were also among the fastest growing areas for foreign direct investment. Foreign investors got a late start in this industry, though. In the private economy, services grew from a 23 percent employment share to 28 percent of all employment from 1974 to 1984--expanding 50 percent in employment over the period. On the other hand, while the employment of foreign-owned Services firms increased 367 percent over the same period, such employment accounted for only 3.9 percent of total FDIUS employment in 1974 and increased to only 7.1 percent of FDIUS employment by 1984. Also, foreign direct investment in Services remained below one percent of all employment in Services.

2.2.4 Finance, Insurance, and Real Estate

An analysis of employment change in F.I.R.E. is complicated by the fact that the U.S. Department of Commerce's Bureau of Economic Analysis (BEA), which prepared the FDIUS employment data, has excluded Banking from the industry employment estimates subsequent to the 1974 Benchmark Survey. As a result, little can be said about Banking, an area of significant FDIUS growth. Insurance is an industry that has experienced above average employment growth in the U.S. And, while the employment of foreign-owned Insurance firms has increased even more, employment growth has still been lower than that for FDIUS as a whole. So, while FDIUS Insurance employment has expanded 88 percent between 1974 and 1984, its importance measured by its share of FDIUS employment has declined, from 3.1 to 2.3 percent

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of FDIUS employment. However, FDIUS has captured increasing shares of the U.S. industry, amounting to 3.3 percent of industry employment by 1984. Growth in FDIUS Real Estate employment has been substantial, expanding 397 percent over the decade. However, FDIUS Real Estate employment has started from a low base in 1974 and still accounts for only one percent of all employment of foreign-owned firms. Still, FDIUS Real Estate employment amounts to 2.2 percent of all Real Estate employment by 1984.

2.2.5 Mining

Mining employment in the U.S. jumped 40 percent between 1974 and 1984, compared to 23 percent for all employment in the private domestic economy. FDIUS Mining employment expanded even more--by 59 percent. However, this was much lower than FDIUS employment growth in the economy at-large.

An interesting contrast to the Petroleum (and Coal) Products industry (in manufacturing) is the Oil and Gas Extraction (Mining) industry. In this industry, net U.S. employment is booming, both in relation to manufacturing as well as other industries, at an average annual compounded growth rate of 7.3 percent. However, FDIUS jobs in Oil and Gas Extraction have grown at a rate of only 6.9 percent a year, below even the rate of increase of FDIUS employment at-large. As a result, the FDIUS share of industry employment has dropped from 3.4 percent in 1974 to 3.3 percent in 1984. Also, the share of FDIUS employment has dropped from one percent to seven tenths of one percent over the same period.

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Metal Mining is an area in which the U.S. industry is experiencing net employment loss and foreign investors are cutting jobs, too. However, while the industry lost almost 43 percent of its jobs between 1974 and 1984, foreign investors only cut back jobs by 20 percent. As a result, foreign-controlled firms saw their share of the industry's employment jump from 14 percent to 20 percent. On the other hand, Metal Mining declined as an industry for foreign direct investment, dropping from 1.3 percent of FDIUS jobs to 0.4 percent.

2.2.6 Other Industries

Construction was the fastest growing division-level industry for foreign-controlled firms between 1974 and 1984. At the same time, it was an industry of slower than average growth for the economy as a whole. Nonetheless, beginning from an insignificant base in 1974, the employment of foreign-owned firms amounted to a fairly miniscule share of Construction industry and FDIUS employment in 1984.

Transportation, Communication, and Public Utilities (T.P.U.) saw below average employment growth in the industry as a whole, as well as foreign-owned firms. However, phenomenal growth in one small segment of the industry grouping, Communication and Public Utilities, accounted for more than half of the aggregate job growth for foreign-owned firms.

Employment in Agriculture, Forestry, and Fishing grew little in the economy as a whole and in foreign-controlled firms. Rates of employment growth were grossly below average for both. This industry accounted for less than half a percent of FDIUS jobs and only two percent of all employment in 1984.

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2.2.7 Summary of Employment Changes in U.S. Industry

The decade from 1974 to 1984 witnessed dramatic changes in job creation within U.S. industry. Manufacturing, which traditionally played an important role in the U.S. economy, lost more than half a million jobs, even as 15 million jobs were created elsewhere in the economy. Services accounted for half the job growth in the economy, Retail provided 29 percent of new jobs, and growth in Wholesale and non-bank F.I.R.E. accounted for another 16 percent of all jobs created.

In strong contrast to U.S. industry, more than half of all jobs added by foreign-owned firms occurred in manufacturing. Growth in the wholesale industry accounted for 20 percent of jobs added. Retail employment growth provided for another 10 percent, and Services accounted for an additional nine percent of all jobs added by foreign direct investors. On the other hand, the rate of growth of employment in foreign-owned manufacturing firms fell below the average rate of increase for all foreign direct investment, indicating a weakening of interest in manufacturing investments as opposed to other industries--just as has been the case with domestic investors. The major difference between foreign and domestic investors is that while domestic manufacturers have cut manufacturing employment dramatically, foreign investors have continued to add jobs in manufacturing at a lower rate than in other industries.

On balance, both foreign direct investors and domestic investors are shifting employment shares to other industries, in many cases the same industries. Foreign firms, however, have shown relatively more interest in marketing operations, such as the wholesale industry, while

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domestic firms have exhibited a greater preference for service industries. In almost all cases, the rate of growth of foreign-firm employment far exceeds that of U.S. industry as a whole, indicating that foreign investors are picking up additional shares of employment and gaining additional economic significance in almost all U.S. industries.

2.3 Recent Employment Growth Across Regions

Just as employment resulting from foreign direct investment has exhibited very different industry growth patterns than that of employment change in the economy as a whole, so too has growth across geographic regions exhibited strikingly different characteristics.[6] Because both industry and geographic variables enter into the unique characteristics that make foreign direct investment different from domestic investment, the disaggregated analysis of employment change by region and industry, together, would be ideal. However, data suppression by BEA for highly disaggregated categories of data makes analysis of regional change across most industries an impossibility.[7]

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[6]The discussion here makes use of revised 1974 employment data for foreign-owned firms prepared by Coleman (1985). Coleman's data are easier to work with because his aggregate employment totals have already been adjusted to exclude banking, as are the 1984 data. The discussion is confined to employment in the 48 continental United States. U.S. employment totals represent only these states. Also, the aggregate industry data for the U.S. is different from that used in the previous section. Rather than reflecting total domestic private employment (or, all employment except for government employment), the data used here are total nonagricultural employment. Although the data are somewhat different, they trend similarly.

[7]Data suppression by BEA occurs when the level of reported employment in a given industry and state (or region) would imperil the anonymity of a foreign-owned firm. Although compliance in responding to the BEA foreign direct investment surveys is required by law, BEA promises full confidentiality of foreign investors in return for their cooperation.

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Aside from aggregate employment in the private domestic economy, the only division-level industries that can be analyzed across regions for 1974 to 1984 are manufacturing and wholesale.[8] All other industries suffer from the suppression of data in one or more regions.

For both foreign-owned and all U.S. firms, the South has added the greatest numbers of jobs between 1974 and 1984. (See Tables 2-3 and 2-4.) 28 percent of all new jobs were created in the Southeast. Foreign-based firms also added 28 percent of their employment growth in the Southeast. However, while another 19 percent of new U.S. employment was created in the Southwest, foreign-based firms' employment only grew by 13 percent in the region. All told, then, while U.S. industry added 47 percent of its new jobs in the South, only 41 percent of FDIUS employment growth occurred in the South. Notwithstanding any apparent difference, both foreign firms and U.S. industry experienced their highest rates of employment growth in the Southwest: 15 percent on an average annual compounded basis for foreign direct investors and 3.9 percent for U.S. industry.

Use of location quotients, a kind of concentration ratio comparing regional employment shares of foreign investors to regional employment shares for the U.S., also provides some revealing information here.[9] When the location quotient is equal to one, the share of FDIUS employment in a region is the same as the share of U.S. employment in

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[8]Because of the way BEA aggregates and classifies manufacturing industry data, investments involving petroleum and coal products (SIC 29) manufacturing are not included in the manufacturing industry data presented in this section.

[9]See Appendix A for information on the calculation of the location quotient.

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the region. If the location quotient is greater than one, the share of foreign-owned firm employment in the region is greater than the share of U.S. employment--in other words, foreign firm employment is relatively more concentrated in the region than U.S. employment. If the location quotient is less than one, the converse is true, and foreign firm employment is relatively less concentrated in the region than U.S. employment. Because the location quotients for the Southeast and Southwest are both very near one in 1984--in fact, they both exceed one slightly--we see that the South has relatively similar attractions for both foreign and domestic firms. The Mideast was also an area of major attraction for foreign investors in 1984, with a location quotient over one, though having decreased from 1974. Outside of the South, FDIUS grew at above average rates everywhere except in the Great Lakes and Mideast states. This was basically true for domestic investors as well, except that New England experienced below average employment growth. Nonetheless, foreign investors added 32 percent of their jobs in the Great Lakes and Mideast states while domestic investors only added 24 percent.

For manufacturing industries, location quotients indicate that the Mideast has demonstrated increasing attraction for foreign direct investors, and above the level for domestic firms. (See Table 2-5.) The Southeast has been experiencing decreasing attraction for FDIUS, while still greater than for domestic firms. The Southwest has gone from being a less desireable location for FDIUS to become more important than for domestic investors. All in all, then, the South and the Mideast are more attractive regions for foreign investors than for domestic ones. Growth rates paint a slightly different picture. For foreign investors, the Southwest has grown the most in importance with an average

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Table 2-3: Regional Distribution of FDIUS Employment, 1974 and 1984

REGION	1974 EMP	FDIUS SHARE	REGION SHARE	1984 EMP	FDIUS SHARE	REGION SHARE	EMP CHANGE	GROWTH SHARE	AVG ANN GR RATE	1974 LOC	1984 LOC
NEW ENGLAND	67141	6.0	1.4	165190	6.2	2.8	98049	6.3	9.4	0.96	0.99
MIDEAST	333867	29.7	2.1	599088	22.4	3.4	265221	17.2	6.0	1.43	1.19
GREAT LAKES	232179	20.6	1.5	462172	17.3	2.8	229993	14.9	7.1	1.02	0.99
PLAINS	45351	4.0	0.8	125240	4.7	1.8	79889	5.2	10.7	0.52	0.63
SOUTHEAST	235588	20.9	1.4	661630	24.8	3.1	426042	27.6	10.9	0.99	1.11
SOUTHWEST	66725	5.9	1.1	269602	10.1	2.9	202877	13.1	15.0	0.72	1.01
ROCKY MOUNTAINS	17022	1.5	0.8	53244	2.0	1.9	36222	2.3	12.1	0.58	0.66
FAR WEST	128091	11.4	1.3	334182	12.5	2.4	206091	13.3	10.1	0.87	0.86
TOTAL	1125964	100.0	1.4	2670348	100.0	2.8	1544384	100.0	9.0	1.00	1.00

NOTE: BECAUSE THE FIGURES ARE ROUNDED, REGIONAL SHARES WILL NOT ADD UP PRECISELY TO 100 PERCENT.

DATA SOURCES: U.S. DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS (1985), AND U.S. DEPARTMENT OF COMMERCE (1976, 1986).

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Table 2-4: Regional Distribution of Total U.S. Nonagricultural Employment (in thousands), 1974 and 1984

REGION	1974 EMP	SHARE	1984 EMP	SHARE	EMP CHANGE	GROWTH SHARE	AVG ANN GR RATE
NEW ENGLAND	4809.3	6.2	5890.8	6.3	1081.5	6.7	2.0
MIDEAST	16102.3	20.7	17650.3	18.8	1548.0	9.6	0.9
GREAT LAKES	15727.5	20.2	16385.0	17.5	657.5	4.1	0.4
PLAINS	6022.0	7.8	7022.9	7.5	1000.9	6.2	1.5
SOUTHEAST	16498.2	21.2	21031.0	22.4	4532.8	28.1	2.5
SOUTHWEST	6353.3	8.2	9357.4	10.0	3004.1	18.6	3.9
ROCKY MOUNTAINS	2031.1	2.6	2819.4	3.0	788.3	4.9	3.3
FAR WEST	10127.2	13.0	13666.3	14.6	3539.1	21.9	3.0
TOTAL	77670.9	100.0	93823.1	100.0	16152.2	100.0	1.9

NOTE: BECAUSE THE FIGURES ARE ROUNDED, REGIONAL SHARES WILL NOT ADD UP PRECISELY TO 100 PERCENT.

DATA SOURCES: U.S. DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS (1985).

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compounded annual growth rate of 19.5 percent, followed by the Rocky Mountains at 13.5 percent, the Plains at 12.1 percent, and the Far West at 10.5 percent. The Southeast showed the lowest FDIUS growth rate among regions: 7.5 percent. With some exceptions, areas that are growth regions for manufacturing FDIUS are also growth areas for domestic investment in manufacturing (see Table 2-6). The important exceptions are the Plains and and New England regions. For domestic manufacturers, the Plains is an area of cutbacks rather than growth. Also, New England is experiencing above average domestic manufacturing growth, while experiencing slow FDIUS growth. Notwithstanding, most foreign manufacturing jobs (39 percent), based on share of job growth (see Table 2-5) have been created in the traditional manufacturing heartland--the Mideast and the Great Lakes. The South comes in a close second with 35 percent of all FDIUS manufacturing jobs added.

Location quotients show wholesale FDIUS to be more attracted to the Mideast, the Far West, and New England than is domestic wholesale investment. (See Table 2-7.) However, only in New England is this a reflection of increasing interest. Foreign investors are increasingly interested in the Southwest and Rocky Mountains for wholesale operations, though less so than for domestic wholesalers. The Southeast has been a region of increasing interest, but only in 1984 has that interest become on par with domestic investors. In terms of growth rates, wholesale FDIUS is increasing at an above average rate in all regions except the Mideast, Great Lakes, and Plains states. This slightly contrasts with domestic wholesaling, which is growing below average in the Mideast, Great Lakes, and New England states (see Table 2-8). 35 percent of all FDIUS wholesale jobs were added in the South

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Table 2-5: Regional Distribution of FDIUS Manufacturing Employment, 1974 and 1984

REGION	1974 EMP	FDIUS SHARE	REGION SHARE	1984 EMP	FDIUS SHARE	REGION SHARE	EMP CHANGE	GROWTH SHARE	AVG ANN GR RATE	1974 LOC	1984 LOC
NEW ENGLAND	41955	7.2	2.9	87135	6.4	5.8	45180	5.8	7.6	1.00	0.83
MIDEAST	149480	25.5	3.6	312016	22.9	9.0	162536	20.9	7.6	1.22	1.28
GREAT LAKES	121249	20.7	2.4	258107	18.9	6.1	136858	17.6	7.8	0.81	0.87
PLAINS	21812	3.7	1.6	68373	5.0	5.1	46561	6.0	12.1	0.56	0.73
SOUTHEAST	167330	28.6	3.9	346362	25.4	7.7	179032	23.0	7.5	1.32	1.09
SOUTHWEST	19080	3.3	1.7	113256	8.3	8.2	94176	12.1	19.5	0.58	1.16
ROCKY MOUNTAINS	6682	1.1	2.2	23624	1.7	6.3	16942	2.2	13.5	0.77	0.89
FAR WEST	57574	9.8	2.7	155816	11.4	6.0	98242	12.6	10.5	0.91	0.86
TOTAL	585162	100.0	2.9	1364689	100.0	7.1	779527	100.0	8.8	1.00	1.00

NOTE: BECAUSE THE FIGURES ARE ROUNDED, REGIONAL SHARES WILL NOT ADD UP PRECISELY TO 100 PERCENT.

DATA SOURCES: U.S. DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS (1985), AND U.S. DEPARTMENT OF COMMERCE (1976, 1986).

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Table 2-6: Regional Distribution of Total U.S. Manufacturing Employment (in thousands), 1974 and 1984

REGION	1974 EMP	SHARE	1984 EMP	SHARE	EMP CHANGE	GROWTH SHARE	AVG ANN GR RATE
NEW ENGLAND	1438.3	7.2	1493.0	7.7	54.7	-7.9	0.4
MIDEAST	4190.3	20.9	3465.0	17.9	-725.3	105.1	-1.9
GREAT LAKES	5159.0	25.7	4226.2	21.8	-932.8	135.2	-2.0
PLAINS	1340.4	6.7	1331.0	6.9	-9.4	1.4	-0.1
SOUTHEAST	4333.4	21.6	4502.7	23.3	169.3	-24.5	0.4
SOUTHWEST	1130.5	5.6	1388.6	7.2	258.1	-37.4	2.1
ROCKY MOUNTAINS	297.9	1.5	374.6	1.9	76.7	-11.1	2.3
FAR WEST	2156.8	10.8	2575.7	13.3	418.9	-60.7	1.8
TOTAL	20046.6	100.0	19356.8	100.0	-689.8	100.0	-0.3

NOTE: BECAUSE THE FIGURES ARE ROUNDED, REGIONAL SHARES WILL NOT ADD UP PRECISELY TO 100 PERCENT.

DATA SOURCES: U.S. DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS (1985).

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as opposed to 39 percent for domestic wholesale employment growth (see Tables 2-7 and 2-8). FDIUS job growth was comparatively more concentrated in the Mideast, where 21 percent of wholesale FDIUS jobs were added--as opposed to 13 percent for domestic investors.

2.3.1 Summary of Employment Change Across Regions

In general, it is apparent for both foreign and domestic-owned firms that employment is dispersing away from areas where employment has been traditionally concentrated. However, a major difference is apparent. For domestic-owned firms, the 1974 to 1984 data indicate fairly massive shifts away from the Mideast and Great Lakes regions to the Southeast, Southwest, and Far West (see Table 2-4). In contrast, foreign-owned firms have added large numbers of jobs in the Mideast and Great Lakes regions, in addition to the southern and western areas favored by domestic-owned employers in recent years (see Table 2-3). This trend is especially pronounced in manufacturing industries, where domestic-owned firms have cutback tremendously on jobs in the Mideast and Great Lakes regions and foreign owned firms have added 39 percent of all FDIUS jobs (see Tables 2-6 and 2-5.[10] Domestic-owned wholesale establishments have been kinder to the Great Lakes and Mideast, with significant numbers of jobs added, while FDIUS wholesalers have added proportionately even greater numbers of jobs to these regions (see Tables 2-8 and 2-7).

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[10]A major failing of the available data is that they allow for analysis of regional employment change across only a couple of division-level industries.

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Table 2-7: Regional Distribution of FDIUS Wholesale Employment, 1974 and 1984

REGION	1974 EMP	FDIUS SHARE	REGION SHARE	1984 EMP	FDIUS SHARE	REGION SHARE	EMP CHANGE	GROWTH SHARE	AVG ANN GR RATE	1974 LOC QUOT	1984 LOC QUOT
NEW ENGLAND	6205	5.0	2.7	16415	5.7	5.6	10210	6.2	10.2	0.92	1.08
MIDEAST	42440	34.2	4.7	77355	26.8	7.2	34915	21.2	6.2	1.61	1.39
GREAT LAKES	19575	15.8	2.5	39660	13.8	4.2	20085	12.2	7.3	0.83	0.81
PLAINS	5024	4.0	1.4	10180	3.5	2.1	5156	3.1	7.3	0.49	0.41
SOUTHEAST	19576	15.8	2.3	61574	21.4	5.2	41998	25.6	12.1	0.77	1.00
SOUTHWEST	6664	5.4	1.7	21254	7.4	3.6	14590	8.9	12.3	0.58	0.70
ROCKY MOUNTAINS	1282	1.0	1.2	4662	1.6	2.8	3380	2.1	13.8	0.40	0.55
FAR WEST	23315	18.8	4.0	57291	19.9	6.9	33976	20.7	9.4	1.36	1.33
TOTAL	124081	100.0	3.0	288391	100.0	5.2	164310	100.0	8.8	1.00	1.00

NOTE: BECAUSE THE FIGURES ARE ROUNDED, REGIONAL SHARES WILL NOT ADD UP PRECISELY TO 100 PERCENT.

DATA SOURCES: U.S. DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS (1985), AND U.S. DEPARTMENT OF COMMERCE (1976, 1986).

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Table 2-8: Regional Distribution of Total U.S. Wholesale Employment (in thousands), 1974 and 1984

REGION	1974 EMP	SHARE	1984 EMP	SHARE	EMP CHANGE	GROWTH SHARE	AVG ANN GR RATE
NEW ENGLAND	228.3	5.4	292.5	5.3	64.2	4.8	2.5
MIDEAST	894.4	21.3	1071.7	19.4	177.3	13.2	1.8
GREAT LAKES	794.0	18.9	944.7	17.1	150.7	11.3	1.8
PLAINS	346.7	8.3	474.0	8.6	127.4	9.5	3.2
SOUTHEAST	857.6	20.4	1176.3	21.2	318.7	23.8	3.2
SOUTHWEST	388.8	9.3	586.3	10.6	197.5	14.8	4.2
ROCKY MOUNTAINS	107.2	2.6	163.9	3.0	56.7	4.2	4.3
FAR WEST	580.6	13.8	826.5	14.9	245.9	18.4	3.6
TOTAL	4197.5	100.0	5535.8	100.0	1338.4	100.0	2.8

NOTE: BECAUSE THE FIGURES ARE ROUNDED, REGIONAL SHARES WILL NOT ADD UP PRECISELY TO 100 PERCENT.

DATA SOURCES: U.S. DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS (1975, 1985).

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2.4 Job Creation and Foreign-Owned Firms

Foreign-owned firms have been making a substantial contribution to job creation, as we have discussed in the preceding section. At least, an analysis of employment growth seems to suggest this. And, it is a common belief that drives the efforts of states and localities to attract foreign direct investment. However, other factors concerning the operations of foreign direct investors may cast doubt on this conclusion. For instance, job creation is generally dependent to some extent on the mode of foreign direct investment entry. While investments in new plants and new businesses ("greenfield" investments) create new jobs, foreign acquisitions of existing U.S. firms may involve no new net job creation. In other words, when a foreign entity purchases a U.S. business, employment usually carries over from one owner to the next. New jobs may or may not be created in the newly-acquired firm. Employment may even be cut back, as the new foreign owners downsize in an attempt to make the business more competitive or strip the firm of portions of its operating assets to pay for the purchase. A recent report by the Congressional Research Service says that (Cooper, 1985, p. 30):

> New investments generally will create jobs, but acquisitions may or may not affect employment levels, depending on the specific case. If foreign owners do not change employment policies set by American owners, the net result would be no change. However, in some cases foreign owners have introduced labor-saving technology and have closed unprofitable plants, thus reducing employment. In other cases, foreign owners have expanded operations, thus increasing employment.

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2.4.1 The Role of Acquisitions

One witness testifying on the role of foreign acquisitions of U.S. firms during Congressional hearings has described the whole problem of assessing the job impacts of foreign acquisitions as being "highly problematic" (House Report No. 96-1216, 1980, p. 16). What makes acquisitions problematic is that they can have many different kinds of effects on employment levels, both within and outside of acquired firms.

Sometimes foreign acquisitions of U.S. firms preserve employment levels in the acquired firms. Sometimes they do not. Why? The foreign investor may or may not modify the operations of the firm to suit an objective different from that of the previous owners. All other things being equal, this generally preserves employment.

A change occurs, however, when the objective of the foreign owners is different than that of the previous owners. Increasingly, many foreign direct investors are behaving just like U.S. corporate raiders, and their objectives, according to some, are to make a fast buck (Glasgall, 1986, p. 84). For instance, in 1986, the U.S. arm of Britain's Hanson Trust PLC purchased the SCM corporation, a chemicals, office equipment, and telecommunications equipment producer, in an hostile takeover for $930 million. Hanson promptly sold off enough of SCM's assets to earn back the purchase price, retaining divisions that would produce $120 million a year in before tax profits (Ibid; Mergers and Acquisitions, July/August 1986, p. 142). To trace through the employment effects of such a series of transactions would be difficult, and one imagines that they could be substantial. In another case, the recent takeover of Allied Stores Corporation by Canada's Campeau

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Corporation was so highly leveraged that Campeau is trying to sell 16 of Allied's 24 chains of retail stores to meet a $1.1 billion bank obligation, and plans are to cut as much as 50 percent of Allied's central corporate staff (Zehr, 1987, p. 12; Cook, Terry, and Dunkin, 1987, pp. 52-53).

Another example of the employment effects of foreign acquisition is the case in which foreign investors invest new capital to update a production process or product line to make a company more competitive in the marketplace. Such changes can involve streamlining a company's production process or adding new production equipment, altering the firm's requirements for labor and leading to layoffs. Some would argue that this is healthy, because some jobs are preserved--and all of the jobs would be lost without the infusion of capital needed to modernize a firm's production.

Not all acquisitions are friendly, whether they involve just U.S. firms and interests or not. An insidious penalty for increasing corporate raids and hostile takeover attempts on the part of foreigners, is that, just like takeover attempts involving U.S. raiders, such moves can lead to layoffs and restructuring in the wake of a U.S. firm's attempts to ward off acquisition. Goodyear's fight to prevent Britain's Sir James Goldsmith from acquiring a controlling interest in the company resulted in threatened layoffs (which may have since become a reality), divestitures of operating units, and pleas for legislation to preempt hostile takeover bids before Congressional; by the time Goldsmith had withdrawn from the deal, he had pocketed $90 million at Goodyear's expense (Crudele, 1986, p. 17; Hershey, 1986, p. 29; Glaberson and Schiller, 1986, p. 22). Goldsmith's attempted acquisition of Crown

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Zellerbach, a California paper products manufacturer resulted in the sell-off of assets and the release of 350 headquarters employees (Weiss, Ellis, and Levine, 1987, p. 274).

Foreign acquisitions of U.S. firms have been increasing dramatically, especially in reported value, over the last couple of years. With the dollar dropping 30 percent in value against major foreign currencies since 1985, U.S. businesses have become "an irresistible buy" for foreign investors, who are rapidly expanding their stake in the economy (Glasgall, Ibid). More than 30 of the top 200 acquisitions of U.S. firms in 1986 involved foreign firms or interests (Business Week, April 17, 1987, pp. 273-292). From 1981 to 1986, eight percent of all acquisitions of U.S. firms were purchases by foreigners, although on a year to year basis they have varied from 5.3 percent to 12 percent. (See Table 2-9.) At the same time, almost 12 percent of the value of all acquisitions was paid out by foreigners. This means that, on average, foreign purchases of U.S. firms involve larger financial transactions than do domestic purchases of U.S. companies. In fact, over the 1981 to 1986 period, the average foreign acquisition of a U.S. firm involved $55.8 million. The average domestic U.S. purchase was only $37.2 million.[11]

Foreign acquisitions of U.S. firms are becoming fairly important in certain industries in terms of the net total of acquisition activity taking place. (See Table 2-10.) At the division level, the industry with

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[11]These averages may not be very meaningful as they are based on incomplete reporting of transaction values. If, on average, foreign acquisition transaction prices were reported as often as U.S. acquisition transaction prices, then it may be reasonable to conclude that foreign acquisitions of U.S. firms generally involve higher dollar amounts.

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Table 2-9: Acquisitions and Mergers in the U.S.: 1981-1986

Numbers of Acquisitions

Year of Completion	U.S. ACQUIRER Number	U.S. ACQUIRER Percent	FOREIGN ACQUIRER Number	FOREIGN ACQUIRER Percent	BOTH TYPES Total	BOTH TYPES Percent
1981	1,964	88.0	267	12.0	2,231	100.0
1982	1,960	89.8	222	10.2	2,182	100.0
1983	2,075	94.7	116	5.3	2,191	100.0
1984	2,729	93.6	186	6.4	2,915	100.0
1985	3,001	93.4	212	6.6	3,213	100.0
1986	3,541	91.5	329	8.5	3,870	100.0
TOTAL	15,270	92.0	1,332	8.0	16,602	100.0

Value of Acquisitions (in $ Billions)

Year of Completion	U.S. ACQUIRER Value	U.S. ACQUIRER Percent	FOREIGN ACQUIRER Value	FOREIGN ACQUIRER Percent	BOTH TYPES Value	BOTH TYPES Percent
1981	56.1	77.5	16.3	22.5	72.4	100.0
1982	59.6	91.6	5.5	8.5	65.1	100.0
1983	48.4	95.7	2.2	4.3	50.6	100.0
1984	115.0	93.3	8.2	6.7	123.2	100.0
1985	124.3	86.9	18.8	13.1	143.1	100.0
1986	165.2	87.6	23.3	12.4	188.5	100.0
TOTAL	568.6	88.4	74.3	11.6	642.9	100.0

Source: Mergers & Acquisitions (1983, 1984, 1985, 1986, 1987).

Note: Values are not available for all transactions.

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the biggest share of foreign acquisitions from 1982 to 1986 is mining. In the mining industry, 12.8 percent of all acquisitions were sponsored by foreign buyers. For manufacturing, nine percent of acquisitions involved foreign buyers. Other division-level industries had significant shares, as well: Agriculture, Forestry, and Fishing (8.3 percent--although the industry had few acquisitions from any source over the period), Retail (8.0 percent), Services (7.1 percent), Wholesale (5.8 percent), and F.I.R.E. (5.8 percent).

Nonetheless, fully half (49.7 percent) of all foreign acquisitions went to manufacturing industries, with Nonelectrical Machinery (7.6 percent), Chemicals (7.3 percent), Electrical Machinery (6.5 percent), and Printing and Publishing (5.5 percent) taking the largest shares of total foreign acquisitions between 1982 and 1986. F.I.R.E. took the next largest share of all foreign acquisitions (17.0 percent), with most concentrated in Finance (11.0 percent), especially Holding and Investment Companies (5.3 percent). Services captured 9.4 percent of all foreign-purchaser acquisitions, with most concentrated in Business Services (7.1 percent). Mining also received a significant share with 7.0 percent of foreign acquisitions--and more than half of these transactions were in the Oil and Gas Extraction industry.

Another way of looking at foreign purchases of U.S. firms from an industry perspective is to compare the share of foreign transactions in an industry to the share of domestic firm transactions in an industry. The result is a "concentration ratio" indicating the relative strength of foreign interest in acquisitions within a given industry, because it compares the share of foreign transactions concentrated in the industry

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to the share of domestic-source transactions drawn to the industry.[12] When the concentration ratio is equal to one, the share of all FDIUS acquisitions in an industry is the same as the share of all domestic-source acquisitions in the industry. If the concentration ratio is greater than one, the share of foreign-buyer acquisitions in the industry is greater than the share of domestic acquisitions--in other words, acquisitions involving foreign buyers are relatively more concentrated in the industry than those involving domestic buyers. If the concentration ratio is less than one, the converse is true, and foreign firm acquisitions are relatively less concentrated in the industry than are domestic-source acquisitions.

Employing this concentration ratio concept, we find that foreign-source acquisitions are more highly concentrated than domestic-source acquisitions in the following division level industries: Mining (ratio of 1.83), Manufacturing (1.23), Agriculture-Forestry-Fishing (1.13), and Retail (1.08). At more disaggregated industry levels, we find that foreign acquisitions are especially concentrated in the following mining industries: Metallic Mining (9.75), Nonmetallic Mining, except coal and fuels (3.65); the following manufacturing industries: Chemicals (2.22), Paper Products (1.99), Stone-Clay-Glass (1.74), and Primary Metals (1.65); an F.I.R.E. industry: Securities and Commodities Brokers (2.24); and a Service industry: Educational Services (1.63).

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[12]See Appendix A for further information on the calculation of concentration ratios.

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Table 2-10: Acquisitions of U.S. Firms by Buyer-Source and Industry: 1982-1986

INDUSTRY (SIC)	INVOLVING FOREIGN BUYERS	SHARE OF FOREIGN	INDUSTRY SHARE	INVOLVING DOMESTIC BUYERS	SHARE OF DOMESTIC	INDUSTRY SHARE	ALL PURCHASES	CONCEN-TRATION RATIO
AGR-FORESTRY-FISHING	4	0.4	8.3	44	0.3	91.7	48	1.13
MINING	74	7.0	12.8	502	3.9	87.2	576	1.83
METAL (10)	22	2.1	44.0	28	0.2	56.0	50	9.75
COAL (11, 12)	5	0.5	12.2	36	0.3	87.8	41	1.72
OIL & GAS (13)	42	4.0	9.8	388	3.0	90.2	430	1.34
NONMETALLIC (14)	5	0.5	22.7	17	0.1	77.3	22	3.65
CONSTRUCTION	7	0.7	4.8	139	1.1	95.2	146	0.63
MANUFACTURING	522	49.7	9.0	5257	40.3	91.0	5779	1.23
FOOD PRODS. (20)	46	4.4	10.4	396	3.0	89.6	442	1.44
TEXTILES (22)	6	0.6	5.1	112	0.9	94.9	118	0.67
APPAREL (23)	4	0.4	3.1	123	0.9	96.9	127	0.40
FURN. & FIXTURES (25)	5	0.5	5.0	96	0.7	95.0	101	0.65
PAPER PRODS. (26)	20	1.9	13.8	125	1.0	86.2	145	1.99
PRINT. & PUBL. (27)	58	5.5	11.3	454	3.5	88.7	512	1.59
CHEMICALS (28)	77	7.3	15.2	430	3.3	84.8	507	2.22
RUBBER & PLAST. (30)	19	1.8	8.7	200	1.5	91.3	219	1.18
LEATHER PRODS. (31)	4	0.4	9.5	38	0.3	90.5	42	1.31
STONE-CLAY-GLASS (32)	22	2.1	12.3	157	1.2	87.7	179	1.74
PRIMARY METALS (33)	25	2.4	11.7	188	1.4	88.3	213	1.65
FABR. METALS (34)	20	1.9	4.7	402	3.1	95.3	422	0.62
NONELEC. MACH. (35)	80	7.6	9.2	793	6.1	90.8	873	1.25
ELECTRICAL MACH. (36)	68	6.5	8.7	711	5.5	91.3	779	1.19
TRANSP. EQUIP. (37)	13	1.2	5.5	223	1.7	94.5	236	0.72
INSTRUMENTS (38)	41	3.9	7.6	499	3.8	92.4	540	1.02
MISCELLANEOUS (39)	10	1.0	5.3	178	1.4	94.7	188	0.70
OTHER MFG. (21, 24, 29)	4	0.4	2.9	132	1.0	97.1	136	0.38
T.P.U.	28	2.7	2.8	970	7.4	97.2	998	0.36
WHOLESALE	43	4.1	5.8	701	5.4	94.2	744	0.76
RETAIL	57	5.4	8.0	658	5.0	92.0	715	1.08
F.I.R.E.	178	17.0	5.8	2872	22.0	94.2	3050	0.77
FINANCE	117	11.1	5.1	2188	16.8	94.9	2305	0.66
BANKING (60)	13	1.2	1.4	943	7.2	98.6	956	0.17
CREDIT AGENCIES (61)	18	1.7	3.6	480	3.7	96.4	498	0.47
SECURITIES BROKERS (62)	30	2.9	15.3	166	1.3	84.7	196	2.24
HOLDING COMPANIES (67)	56	5.3	8.5	599	4.6	91.5	655	1.16
INSURANCE (63-64)	42	4.0	8.6	447	3.4	91.4	489	1.17
REAL ESTATE (65-66)	19	1.8	7.4	237	1.8	92.6	256	1.00
SERVICES	99	9.4	7.1	1305	10.0	92.9	1404	0.94
BUSINESS SERVICES (73)	75	7.1	6.6	1054	8.1	93.4	1129	0.88
DATA PROC. SERV. (737)	22	2.1	4.1	510	3.9	95.9	532	0.54
OTHER BUS. SERVICES	53	5.0	8.9	544	4.2	91.1	597	1.21
MOTION PICTURES (78)	10	1.0	8.9	102	0.8	91.1	112	1.22
HEALTH SERV. (80)	11	1.0	4.0	264	2.0	96.0	275	0.52
EDUCATIONAL SERV. (82)	5	0.5	11.6	38	0.3	88.4	43	1.63
ENGINEERING (89)	7	0.7	5.7	116	0.9	94.3	123	0.75
OTHER SERVICES	14	1.3	5.5	241	1.8	94.5	255	0.72
TOTAL	1050	100.0	7.5	13036	100.0	92.5	14086	1.00

NOTE: THE CONCENTRATION RATIO IS THE RATIO OF THE INDUSTRY SHARE OF FOREIGN TRANSACTIONS TO THE INDUSTRY SHARE OF DOMESTIC TRANSACTIONS.
SOURCE: MERGERS & ACQUISITIONS MAGAZINE (1983-1987).

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2.4.2 Acquisitions and Employment Change in Firms Owned by Foreign Investors

A problematic aspect of foreign acquisitions is that the employment growth attributable to foreign direct investment is influenced by the transfer of employment from domestic to foreign-owned firms. In other words, some gains in foreign-firm employment may be nothing more than a shifting of jobs from one category of firm ownership to another.[13] While foreign acquisitions of U.S. businesses are generally fewer than new "greenfield" investments, their influence on the employment growth of foreign-owned firms may be far more substantial.

Data collected by BEA indicate that from 1979 (the earliest year such data are available) through 1985, foreign direct investment transactions produced very little new employment. (See Table 2-11.) While almost 60 percent of foreign direct investment transactions involved new business startups, only 3.7 percent of the employment placed on foreign firm rosters for the period resulted from the first-year operations of new businesses. Tables 2-12 and 2-13 provide similar data

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[13]Woodward (1986) used just such a "shifting" of employment to compare and contrast the employment growth experience of "domestic" and foreign-owned firms. He separated out FDIUS employment from U.S. employment to derive "domestic" employment. Based on an analysis of the resulting data, he concluded that the employment growth performance of domestic-owned firms in comparison to foreign-owned firms was much worse than it actually is. This is because some of the foreign-firm employment gain counts as a loss of "domestic" firm jobs, when in fact, the jobs are simply transferred from the "domestic" roster of firm ownership to that of the foreign-owned firm.

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for manufacturing and wholesale industries.[14] While most foreign direct investments involve the startup of entirely new operations, this does not hold true for manufacturing or wholesale industries. As can be seen in Table 2-12, 82 percent of the foreign direct investment transactions for manufacturing between 1979 and 1984 involved acquisitions. Notwithstanding the greater proportion of acquisitions for manufacturing, about the same proportion of new business employment during the first year of operations was created for manufacturing as for all industries over the 1979 to 1985 period--3.1 percent instead of 3.7 percent. Of all the jobs created by new establishments in their first year of operations, 44 percent of the jobs were in manufacturing. Interestingly enough, as Table 2-13 shows, while the proportion of acquisitions was even higher in the wholesale industry, an even greater proportion of foreign-firm employment in the wholesale industry was created by new startups--9.7 percent. While the average new foreign-owned business created 14.3 jobs in its first year of operations between 1979 and 1984, a foreign-owned manufacturing startup created 135.2 jobs, and a new wholesale operation was worth 53.8 new employment opportunities.

2.4.3 Accounting for Change in the Employment of Foreign-Owned Firms in the U.S.

While some foreign direct investments create jobs, others clearly do not. An investment in a new plant or business will create a certain number of new jobs, at least initially. Over time, it may or may not

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[14]Because of the way BEA aggregates and classifies manufacturing industry data, investments involving petroleum and coal products (SIC 29) manufacturing are not included in the manufacturing industry data presented in this section.

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Table 2-11: Acquisitions of U.S. Businesses and New U.S. Business Startups by Foreign Direct Investors

Type and Numbers of Investments

Year of Investment	Acquisitions	Percent	New Businesses	Percent	Both Types
1979	666	42.5	902	57.5	1,568
1980	721	43.5	938	56.5	1,659
1981	462	34.7	870	65.3	1,332
1982	395	35.6	713	64.4	1,108
1983	299	38.6	476	61.4	775
1984	315	41.2	449	58.8	764
1985	287	56.5	221	43.5	508
Total	3,145	40.8	4,569	59.2	7,714

Investment-Related Employment

Year of Investment	Acquisitions	Percent	New Businesses	Percent	Both Types
1979	314,548	95.3	15,467	4.7	330,015
1980	279,459	95.5	13,022	4.5	292,481
1981	428,745	96.8	14,072	3.2	442,817
1982	225,673	96.5	8,169	3.5	233,842
1983	102,557	94.9	5,556	5.1	108,113
1984	168,406	97.6	4,139	2.4	172,545
1985	235,667	96.8	7,772	3.2	243,439
Total	1,755,055	96.3	68,197	3.7	1,823,252

Note: Acquired firm employment is for the fiscal year preceding the acquisition. New Firm Employment is actual or projected for the first year of operation.

Sources: Bureau of Economic Analysis (1981, 1982, 1983, 1984, 1985, 1986).

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Table 2-12: Acquisitions of U.S. Manufacturing Firms and New Manufacturing Plants Startups by Foreign Direct Investors

Types and Numbers of Investments

Year of Investment	Acquisitions	Percent	New Businesses	Percent	Both Types
1979	208	77.0	62	23.0	270
1980	190	82.6	40	17.4	230
1981	178	82.8	38	17.2	215
1982	155	85.6	26	14.4	181
1983	124	84.4	23	15.6	147
1984	96	86.5	15	13.5	111
Total	951	82.3	204	17.7	1,155

Investment-Related Employment

Year of Investment	Acquisitions	Percent	New Businesses	Percent	Both Types
1979	142,982	92.8	11,146	7.2	154,128
1980	142,851	98.0	2,935	2.0	145,786
1981	301,782	98.0	6,066	2.0	307,848
1982	83,786	96.6	2,989	3.4	86,775
1983	51,812	95.2	2,597	4.8	54,409
1984	60,040	97.0	1,857	3.0	61,897
1985	135,898	98.5	2,108	1.5	138,006
Total	919,151	96.9	29,698	3.1	948,849

Note: Acquired firm employment is for the fiscal year preceding the acquisition. New Firm Employment is actual or projected for the first year of operation.

Sources: Bureau of Economic Analysis (1981, 1982, 1983, 1984, 1985); Lowe (1987).

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Table 2-13: Acquisitions of U.S. Wholesale Businesses and New Wholesale Business Startups by Foreign Direct Investors

Types and Numbers of Investments

Year of Investment	Acquisitions	Percent	New Businesses	Percent	Both Types
1979	50	72.5	19	27.5	69
1980	37	77.1	11	22.9	48
1981	26	65.0	14	35.0	40
1982	39	62.9	23	37.1	62
1983	27	71.1	11	28.9	38
1984	26	81.2	6	18.8	32
Total	205	70.9	84	29.1	289

Investment-Related Employment

Year of Investment	Acquisitions	Percent	New Businesses	Percent	Both Types
1979	7,600	88.5	989	11.5	8,589
1980	14,266	98.2	267	1.8	14,533
1981	5,892	83.4	1,174	16.6	7,066
1982	10,942	87.2	1,600	12.8	12,542
1983	3,078	94.9	165	5.1	3,243
1984	12,744	97.5	328	2.5	13,072
1985	3,303	66.0	1,702	34.0	5,005
Total	57,825	90.3	6,225	9.7	64,050

Note: Acquired firm employment is for the fiscal year preceding the acquisition. New Firm Employment is actual or projected for the first year of operation.

Sources: Bureau of Economic Analysis (1981, 1982, 1983, 1984, 1985); Lowe (1987).

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create more jobs or cut back on those created. A foreign-acquired firm may or may not create more jobs or cut back on employment levels existing at the time of acquisition. In either case, future job creation depends on a number of factors, including the market for a firm's products or services, the steps a firm takes to remain competitive in an industry, and access to capital for expansion or transition to competitive types or modes of production.

Too often, perhaps, foreign direct investment is uncritically welcomed as the harbinger of new jobs, technology, and management. It is thought of as representing highly competitive business enterprise, almost magically transforming the U.S. economic landscape, adding new jobs and opportunities while domestic-owned firms suffer from some kind of malaise. As mentioned earlier, a number of analysts have even attributed extensive job creation to foreign-owned firms, even while the economy has been in the middle of recessionary doldrums (see Little, Kahley, and Wilkins, ops. cit.). At best, this only represents uncritical analysis and wishful thinking. At worst, it implies that more than one analyst has simply summed the employment change of foreign-owned firms over time without taking into consideration that the employment change is predominantly driven by the addition of stocks of acquired firm employment. The volume of acquisitions masks the actual job creation, if any, within foreign-owned firms.

In addition to creating jobs, foreign-owned firms lay off workers just as domestic-owned establishments do. They are not, perhaps, the magical enterprises that communities seek, firms that will forever expand and grow, companies that will never become uncompetitive, businesses that are virtual job-creating *manna from heaven.* Instead they operate

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much as domestic-owned firms do, and have many of the same problems-- the potential to lay off workers or go out of business. In fact, during the 1981-1982 recessionary period, many foreign-owned firms were laying off employees. In 1981, layoffs were widespread in primary metals, machinery, and chemicals manufacturing (Survey of Current Business, November 1983, p. 20). This was even as foreign-owned chemical manufacturers netted an increase of 129,811 jobs and foreign-owned machinery producers recorded an increase of 7,388 employees in 1981. The increases were driven by acquisitions of existing firms. According to Howenstine (1984, p. 26), "as a result of the U.S. recession, many U.S. [foreign-owned] affiliates laid off employees in 1982."

In 1982, the employment of foreign-owned firms declined in mining, petroleum, and manufacturing "mainly because layoffs were widespread and the employment added due to acquisitions was small" (Ibid). French-owned metal, glass, and transportation equipment manufacturers were hard hit by recession-related layoffs. German-owned chemical and machinery producers were similarly hit by the recession. One German-owned firm sold or closed a number of unprofitable supermarkets. All of this occurred even as foreign acquisitions of U.S. firms, particularly in retail, added employment to the rosters of foreign-owned firms (Ibid).

BEA made a systematic attempt to account for the change in employment of foreign-owned businesses in 1982, 1983, 1984, and 1985. The results are shown in Table 2-14. As can be seen, substantial job losses occurred in foreign-owned firms, job losses that substantially cancelled out any expansions resulting from the expansions of existing

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operations. If we assume that only about four percent of the jobs attributable to new investments in Line 1 of Table 2-14 are newly created jobs owing to the establishment of new businesses (see Table 2-11), and factor in the sale or liquidation (which may or may not involve employment loss) of existing operations, then very few jobs were created from 1982 to 1985, indeed.

One of the problems with these data is that they really do not allow for an assessment of the actual numbers of jobs created or lost by foreign-owned firms. Over a four year period, we see that the job losses from cutbacks in existing operations far outweigh the expansions. If we discount all but the last two years of the period on the grounds that 1982 and 1983 were recessionary years, then we observe slim employment expansion relative to cutbacks in 1984 and a return to massive cutbacks in 1985. Given such data, one really cannot make an adequate determination of job gains or losses from foreign direct investment in the U.S. But, one suspects that the job-creation record is poor.

2.4.4 Calculating the Direct Job Creation Effects of Foreign Direct Investment

Ideally, in order to determine how many jobs are directly created by foreign direct investment in the U.S., we need to quantify the employment growth in foreign-owned firms over a given time period, separate out the acquired firm employment that is added to total FDIUS employment at the time of the acquisition, and add any employment that is retained at divestiture in firms that are sold by foreign-owners during the period. Over a given time period, the

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Table 2-14: Sources of Change in the Employment of Foreign-Owned Firms

Employment Change	1982	1983	1984	1985	Total
Annual Change	31,497	98,465	167,781	139,295	435,038
Change Resulting From:					
1-New Investments	185,506	156,745	178,804	214,830	735,885
2-Expansions	36,488	76,103	76,019	60,460	249,070
3-Cutbacks	-136,939	-83,351	-66,088	-108,871	-395,249
4-Sales or Liquidations	-63,453	-70,637	-57,783	-56,151	-248,024
5-Combination of New Investments and Sales or Liquidations	4,445	24,689	6,275	13,623	49,032
6-Unaccounted for	5,450	-5,093	30,554	15,404	46,315

Notes: While annual change is for all foreign-owned firms, lines 1-6 are for large firms only (1982 and 1984-85: firms with 500+ employees; 1983: firms with 400+ employees). New investments are acquisitions and new establishments. Line 5 is the employment change for firms that both acquired and sold or liquidated a business during the year. Line 6 is the employment change not accounted for by large firms.

Sources: Howenstine (November 1985, May 1987); Survey of Current Business (1986).

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calculation should yield the sum of all new jobs created by foreign-owned firms--whether in acquired firms or de novo establishments.

Unfortunately, no convenient data exists to help us quantify the employment retained in foreign-owned firms that have been sold or spun off to domestic investors. Other data are available, however. If we assume that foreign direct investment involves long-term commitments, then we should expect that the employment effect of divestitures would be small. This is a strong assumption. Nonetheless, making the assumption that foreign-owned firms do not experience employment losses due to the transfer of "operating" units to domestic owners, we can make a rough calculation that may suggest the magnitude and certainly the direction of direct job creation effects in foreign-owned businesses. At best, it is a "guesstimate," though a suggestive one. Even if the "no-divestiture" assumption is not a realistic one, some feel for the success of operations of foreign-owned firms can be obtained.

Data available from BEA allow for the calculation of the employment growth effect of foreign direct investment on a year to year basis from 1978 to 1984.[15] BEA has also published a data series, beginning in 1979, which contains employment estimates for foreign-acquired firms and new foreign-onwed businesses in the U.S.[16] Having

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[15]The "employment growth" discussed in a previous section made use of data from a 1974 benchmark study to analyze growth over the ten year period, 1974 to 1984, and did not require annual estimates of FDIUS employment.

[16]These data are somewhat crude estimates. The acquired firm employment is employment for, or as of the end of, a firm's fiscal year preceding the date of acquisition. The new business employment is actual or projected employment for the first year of a firm's operations.

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these data, the calculation of jobs created involves simply subtracting all acquired firm employment for the year of a reported transaction from change in total foreign-firm employment that has occurred since the preceding year. Note that the resulting "jobs created" are only meaningful if an assumption of "no-divestitures" is valid. If the assumption is not valid, then this calculation of jobs created deflates the actual number. Table 2-15 shows the results of this calculation for the 1979 to 1984 time period.

The data support the notion that foreign-owned firms lost (or divested) a great deal of employment, especially during the 1981-1982 recessionary period. The order of magnitude is staggering. Foreign firms laid off (or lost through divestment) almost 234,000 workers between 1979 and 1984--an amazing 18 percent of all the employees added through acquisition, de novo establishments, or firm growth. Recall that most of the jobs added were added through acquisition of existing firms; these jobs should not be confused with newly created jobs, as they already existed at the time of acquisition. The losses in manufacturing (see Table 2-16) are even more staggering considering that the employment loss is a full 36.5 percent of all FDIUS manufacturing jobs added from 1979 to 1984. Again, the vast majority of jobs added were through acquisition of existing U.S. manufacturers. Even more incredible, the manufacturing job losses represent 90 percent of all jobs lost by foreign-owned firms between 1979 and 1984. Of course, the implications are that foreign direct investors suffered from the recessionary 1981-1982 period as did domestic-owned firms--and they either laid off proportionately more workers than domestic firms or they went through a period of substantial restructuring through divestment. This is a pointed rebuke to those who claim foreign-owned firms buoyed

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U.S. employment during the last recession. On the other hand, as Table 2-17 shows, a substantial number of jobs were created in at least one area--the wholesale industry over the 1979 to 1984 period, with the exception of 1983. On balance, wholesale foreign-owned firms created a fair number of jobs--altogether some 66,000. Unfortunately data suppression by BEA prevent extension of this analysis to other industries.

Table 2-15: Jobs Added or Lost by Foreign Direct Investors in the United States

Time Period	Employment Change	Acquired Employment	Jobs In New Businesses	Jobs Lost or Added
1979	323,317	314,548	15,467	8,769
1980	280,744	279,459	13,022	1,285
1981	382,633	428,745	14,072	-46,112
1982	31,497	225,673	8,169	-194,176
1983	98,452	102,557	5,556	-4,105
1984	168,804	168,406	4,139	398
Total	1,285,447	1,519,388	60,425	-233,941

Sources: Bureau of Economic Analysis (Dec. 1984, Dec. 1985, 1985, Oct. 1986, Oct. 1986); Survey of Current Business (Jan. 1981, Aug. 1981, June 1982, June 1983, May 1984, May 1984).

2.4.5 Job Creation and the Regions

The foregoing analysis can be extended, with difficulty, to the U.S. regions. The difficulty arises from the fact that BEA cannot provide data on foreign acquisitions of U.S. firms on a regional basis. However, the employment change over time of foreign-owned firms is available on a geographic basis. The challenge, then, is to find a way

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Table 2-16: Jobs Added or Lost by Manufacturing Foreign Direct Investors in the U.S.

Time Period	Employment Change	Acquired Employment	Jobs In New Businesses	Jobs Lost or Added
1979	202,101	142,982	11,146	59,119
1980	98,894	142,851	292	-43,957
1981	195,043	301,782	6,066	-106,739
1982	-58,404	83,786	2,989	-142,190
1983	79,868	51,812	2,597	28,056
1984	56,312	60,040	1,857	-3,728
Total	573,814	783,253	24,947	-209,439

Sources: Bureau of Economic Analysis (Dec. 1984, Dec. 1985, 1985, Oct. 1986, Oct. 1986); Survey of Current Business (Jan. 1981, Aug. 1981, June 1982, June 1983, May 1984, May 1984).

Table 2-17: Jobs Added or Lost by Wholesale Foreign Direct Investors in the U.S.

Time Period	Employment Change	Acquired Employment	Jobs In New Businesses	Jobs Lost or Added
1979	24,102	7,600	989	16,502
1980	21,346	14,266	267	7,080
1981	36,759	5,892	1,174	30,867
1982	26,176	10,942	1,600	15,234
1983	-10,677	3,078	165	-13,755
1984	23,120	12,744	328	10,376
Total	120,826	54,522	4,523	66,304

Sources: Bureau of Economic Analysis (Dec. 1984, Dec. 1985, 1985, Oct. 1986, Oct. 1986); Survey of Current Business (Jan. 1981, Aug. 1981, June 1982, June 1983, May 1984, May 1984).

to allocate the employment of acquired firms over regions, when such data are not directly available.

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While the BEA cannot provide data on acquisitions by region, another unit of the Commerce Department, the International Trade Administration (ITA) maintains an independent data base, recording investments announced through the press and other publicly available sources. While the data collected by ITA are not strictly compatible with the BEA data series, they trend similarly in many respects. ITA records publicly announced acquisitions and mergers, new plants, and a variety of other investment modes.[17] ITA does not in most cases record the employment associated with investments. The investments recorded by ITA may not in all cases be "new" investments. BEA, on the other hand, only records new investments--acquisitions of existing businesses (which presumably includes mergers) and establishments of new business enterprises. The best ITA equivalent for BEA acquisitions should be "acquisitions" and "mergers," which ITA defines as follows (U.S. Dept. of Commerce, September 1986, p. 101):

Acquisition -- A transaction in which title to stock or assets of the U.S. target is secured by another person or enterprise. The substantive result is that one party obtains ownership of another.

Merger -- A transaction which results in the dissolution of the acquired business enterprise, into either another already existing or into a reorganized (but not always renamed) company.

ITA defines "new plant" as "a new operating facility, established either in conjunction with an existing foreign-owned

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[17]Other investment types recorded by ITA include joint ventures, real estate, plant expansion, equity increase, and "other," presumably anything that does not fit into one of the other categories.

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productive enterprise or as a completely new venture" (Ibid, p. 102). Even if ITA's "acquisitions" and "mergers" are for the most part equivalent to BEA's "acquisitions," and if ITA's "new plants" are relatively similar in meaning to BEA's "new establishments," compatibility problems remain. Nonetheless, for wont of alternatives, the ITA "new" investment transactions are used in this analysis as rough surrogates for the BEA investment transactions.

This analysis is dependent on estimating the employment of foreign-acquired firms across regions. As such, a number of steps are required. First, it is necessary to make the assumption that average employment per acquisition or new business is the same across regions--and the BEA data are used to calculate the averages. Average employment per acquisition is calculated for the 1979 to 1984 period by taking the sum of the employment of all aquisitions for the period and dividing the result by the sum of the number of acquisitions. Average employment per new establishment is the sum of the employment of all new establishments divided by the sum of the number of new establishments. Doing this, we find that average employment per acquisition, e_{acq}, is 531.6 workers and average employment per new establishment, e_{est}, is 14.3. Next, we use e_{acq} and e_{est}, as well as the number of acquisitions, n_{acq}, and new establishments, n_{est}, in a given region, i, for 1979 to 1984, to calculate the share $s^{i}_{acq(emp)}$ of acquired employment represented by all transactions in each region:

$$s^{i}_{acq(emp)} = \frac{n^{i}_{acq} \times e_{acq}}{(n^{i}_{acq} \times e_{acq})(n^{i}_{est} \times e_{est})}$$

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Next, $s^{i}_{acq(emp)}$ is multiplied by the regional sum of ITA acquisitions and mergers, n^{i}_{acq}, to obtain a preliminary estimate of foreign-acquired firm employment for each region, i: $e^{i}_{acq(prelim)}$. This preliminary acquired employment estimate, e^{i}_{acq}, is used to determine the percentage, $p^{i}_{acq(emp)}$, of acquired firm employment to allocate to the region, i:

$$p^{i}_{acq(emp)} = \frac{e^{i}_{acq}}{\sum_{i=1}^{9} e^{i}_{acq}}$$

The result of this operation, $p^{i}_{acq(emp)}$, is the estimated share of acquired firm employment that should be allocated to the region. Fortunately, we know from the BEA new foreign investment surveys the actual U.S. total of acquired firm employment for the 1979 to 1984 period. Multiplying total acquired firm employment against our estimated region share of acquired firm employment results in the final estimate of acquired employment for the region. The estimates of jobs added or lost by foreign direct investors are calculated as before, in the preceding section, and is simply the result of subtracting acquired-employment from employment change in the region. The results of this series of operations for all industries, manufacturing, and wholesale are presented in Tables 2-18, 2-19, and 2-20.

The estimated direct job losses (through actual layoffs or disinvestment) for regions owing to the operations of foreign-owned firms for all industries are depicted in Table 2-18. The estimates are

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instructive. While foreign direct investors in all regions would appear to have lost significant numbers of jobs over the 1979 to 1984 period, the data suggest that some have been hurt worse than others. For instance, while the Southeast has taken the greatest share of jobs lost, 25.6 percent, it is the only region whose share of jobs lost is smaller than its share of the FDIUS employment change from 1979-84--in this case, 27.1 percent. So, while the Southeast took the greatest share of increased FDIUS employment, it also took the lowest share of jobs lost owing to foreign direct investors. This suggests that while foreign-owned businesses have been adding more employment to their payolls in the Southeast than elsewhere, they have layed off fewer employees or divested less in the Southeast than in other regions. In the case of New England, the Southwest, and "Other" areas[18], the percentage of jobs lost has equalled the share of FDIUS employment change for each region. In all other areas, the share of jobs lost has been disproportionate to the share of additional FDIUS employment.

Manufacturing presents a similar picture (see Table 2-19), except that in this case, the Southeast and Southwest have both benefited most from foreign direct investment by losing smaller shares of jobs than have other regions. By contrast, while the Mideast and Great Lakes regions gained 36.6 percent of the increase in FDIUS manufacturing jobs from 1979 to 1984, the two regions also took 45.8 percent of all FDIUS job losses--signifying that the traditional manufacturing heartland experienced big losses of employment owing to foreign investors, or higher than average levels of foreign-firm divestment.

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[18]The "Other" category includes principally Alaska, Hawaii, Puerto Rico, as well as other territories.

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Wholesale foreign direct investment presents another picture, altogether (see Table 2-20). The distribution of FDIUS employment change and jobs added is very similar for all regions. The Far West, New England, and "Other" areas have added proportionately slightly larger shares of jobs than the change in FDIUS jobs would indicate, meaning that more jobs were created, or less divestment took place, in these regions than in others. On the whole, however, the job creation performance of foreign direct investors, to the extent that we can infer it, was greater in the Far West, New England, and "Other" areas.

Table 2-18: Jobs Added or Lost by Foreign Direct Investors in U.S. Regions: 1979-1984

Region of the U.S.	Employment Change	Percent Change	Estimated New Invest. Acquired Employment	Share of Acq. Emp.	Jobs Lost or Added	Percent Lost/ Added
New Engl.	79,913	6.2	94,404	0.987	-14,491	6.2
Mideast	253,799	19.7	301,090	0.991	-47,291	20.2
Gr. Lakes	191,419	14.9	227,492	0.993	-36,073	15.4
Plains	53,121	4.1	62,997	0.991	-9,876	4.2
Southeast	348,566	27.1	408,459	0.979	-59,893	25.6
Southwest	166,188	12.9	196,461	0.988	-30,273	12.9
Rocky Mntns	27,813	2.1	33,237	0.998	-5,424	2.3
Far West	154,624	12.0	183,318	0.991	-28,694	12.3
Other	10,004	0.8	11,929	0.996	-1,925	0.8

Note: "Acquired employment" and "jobs lost/added" are estimates whose calculation is described above. The "Other" category includes principally Alaska, Hawaii, Puerto Rico, as well as other territories.

Sources: Bureau of Economic Analysis (Dec. 1984, Dec. 1985, 1985, Oct. 1986, Oct. 1986); Survey of Current Business (Jan. 1981, Aug. 1981, June 1982, June 1983, May 1984, May 1984); International Trade Administration (foreign direct investment transactions data obtained on tape).

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Table 2-19: Jobs Added or Lost by Manufacturing Foreign Direct Investors in U.S. Regions: 1979-1984

Region of the U.S.	Employment Change	Percent Change	Estimated Acquired Employment	New Invest. Share of Acq. Emp.	Jobs Lost or Added	Percent Lost/ Added
New Engl.	33,767	5.9	48,126	0.921	-14,359	6.9
Mideast	118,898	20.7	172,008	0.934	-53,110	25.4
Gr. Lakes	91,062	15.9	133,835	0.949	-42,773	20.4
Plains	24,340	4.2	34,219	0.908	-9,879	4.7
Southeast	159,765	27.8	194,944	0.788	-35,179	16.8
Southwest	74,828	13.0	97,106	0.838	-22,278	10.6
Rocky Mntns	9,910	1.7	14,939	0.974	-5,029	2.4
Far West	58,821	10.2	84,722	0.930	-25,901	12.4
Other	2,423	0.4	3,353	0.894	-930	0.4

Note: "Acquired employment" and "jobs lost/added" are estimates whose calculation is described above. The "Other" category includes principally Alaska, Hawaii, Puerto Rico, as well as other territories.

Sources: Bureau of Economic Analysis (Dec. 1984, Dec. 1985, 1985, Oct. 1986, Oct. 1986); Survey of Current Business (Jan. 1981, Aug. 1981, June 1982, June 1983, May 1984, May 1984); International Trade Administration (foreign direct investment transactions data obtained on tape).

2.4.6 Summary of Discussion on Job Creation

While the available data to not allow for an actual determination of the numbers of jobs created by foreign direct investors, it is readily apparent that the job creation effect, if any, must be minimal. Because foreign-owned firm job growth is generally less than the employment change that can be accounted for by the volume of acquistions, the suggestion is that foreign-owned firms have either layed off significant numbers of workers, or undergone fairly major

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Table 2-20: Jobs Added or Lost by Wholesale Foreign Direct Investors in the U.S.: 1979-1984

Region of the U.S.	Employment Change	Percent Change	Estimated Acquired Employment	New Invest. Share of Acq. Emp.	Jobs Lost or Added	Percent Lost/ Added
New Engl.	7,240	6.0	3,221	0.908	4,019	6.1
Mideast	23,564	19.5	11,030	0.955	12,534	18.9
Gr. Lakes	18,274	15.1	8,283	0.925	9,991	15.1
Plains	3,904	3.2	1,913	1.000	1,991	3.0
Southeast	31,504	26.1	14,460	0.937	17,044	25.7
Southwest	10,862	9.0	5,043	0.948	5,819	8.8
Rocky Mntns	2,318	1.9	1,136	1.000	1,182	1.8
Far West	21,698	18.0	9,437	0.888	12,261	18.5
Other	1,462	1.2	0	0.000	1,462	2.2

Note: "Acquired employment" and "jobs lost/added" are estimates whose calculation is described above. The "Other" category includes principally Alaska, Hawaii, Puerto Rico, as well as other territories.

Sources: Bureau of Economic Analysis (Dec. 1984, Dec. 1985, 1985, Oct. 1986, Oct. 1986); Survey of Current Business (Jan. 1981, Aug. 1981, June 1982, June 1983, May 1984, May 1984); International Trade Administration (foreign direct investment transactions data obtained on tape).

restructuring accompanied by the sale or spinoff of substantial operating units. In truth, we cannot determine which is the more prevalent process. However, a comparison of foreign firm "job loss," as determined by the magnitude of "missing" employment after accounting for acquisitions, suggests that actual job loss may be significant. Foreign-owned firms gave up or lost significant numbers of jobs between 1979 and 1984, especially in manufacturing, and while all regions may have been hit by FDIUS job losses, the Great Lakes and Mideast regions--the manufacturing "Rust Belt"--account for a good portion of the employment loss.

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2.5 Concluding Thoughts

What can be concluded from this discussion? While the data are incomplete, it is apparent that the employment of foreign direct investors is concentrated in different industries than that resulting from domestic investment--and principally manufacturing. Increasingly, however, the employment gains of foreign direct investment are being dispersed to other industries, as are the employment gains owing to all investors. Nonetheless, the growth rate of FDIUS employment far exceeds that of domestic employment in virtually all industries. This is leading to increasing employment penetration in almost all industries--giving rise to an increasing incidence of Americans owing their livelihoods to foreign employers.

While the growth of FDIUS jobs is nothing less than remarkable, it is important to note that most of the job growth is the result of firms changing hands--simple transfers of firms to foreign-ownership, along with employees. This occurs because foreign acquisitions far outweigh new foreign-firm startups in the United States. As has been demonstrated, the growth of employment due to acquisition raises questions about the actual contribution to job creation made by foreign direct investors. While it is not possible to say anything definitive on the issue of job creation as a result of this analysis, it is all too apparent that significant job loss or divestment of operating units, along with great numbers of jobs, accompanies acqusitions. This is especially true in manufacturing. One area where job creation may be significant, or divestment a less desired strategy, is in the wholesale industry.

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Chapter 3

Linkages and Foreign Direct Investment

3.1 Introduction

Foreign direct investment in the U.S. (FDIUS) has heated up temendously over the last several years. Measured in employment, about half of this investment has occurred in the manufacturing sector (Bureau of Economic Analysis, October 1986, p. 44). This growth in manufacturing FDIUS is regarded as especially significant for a number of reasons, including the following:

1. manufacturing has traditionally been regarded as a fundamental industry base for economic development purposes,

2. manufacturing has generally been a source of higher-than-average-wage employment,

3. much domestic manufacturing is in a state of both relative and absolute employment decline, and

4. foreign direct investment is thought to be a source of new technologies, management styles, and production techniques with the capability to reinvigorate manufacturing and enhance local economies.

All of these factors have fed the notion that local economies can benefit from the introduction of foreign firms.

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Growth in foreign direct investment has been matched by a surging competition between cities, states, and regions, each vying for a larger share of new foreign-owned plants and businesses[19]. The competition has pitted community against community, and state against state, in a battle where the weapons are often costly tax reductions and expensive subsidies--offered in the hope of luring new industrial activity and new jobs. There are few estimates available of the costs and extent of such activities. However, they are acknowledged to be considerable and widespread. For example, the subsidies offered for the construction of a Volkswagen assembly plant in Pennsylvania in 1978 amounted to 20 percent of the total capital outlay for the project, and a subsidy of about $4,103 per job (U.S. General Accounting Office, June 3, 1980, p. 42). The $86 million Indiana recently offered in incentives to obtain a Japanese auto assembly plant amounted to about $50,588 spent for each job directly created (Wilkerson, February 2, 1987, p. E4). Kentucky offered a $125 million incentive package to lure a Toyota assembly plant. Such incentive schemes are becoming legion.

This competition is a fairly recent phenomenon. Only ten states had committed funds to attracting foreign investment before 1969. By 1980, all but three states were funding activities for attracting foreign investors--and they were doing so to the tune of about $8.5 million dollars (Kline, 1983, pp. 57-58). A 1985 survey showed that just

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[19]See for example: Makino, Yo. State Officials Compete to lure More Japanese Firms to Their Home Turf, Japan Economic Journal, June 12, 1984, p. 13; and Gordon, Michael R. With Foreign Investment at Stake, It's One State Against the Others, National Journal, Vol. 12, No. 42, October 18, 1980, p. 1744; and U.S. General Accounting Office, Foreign Direct Investment in The United States--The Federal Role, ID-80-24, June 3, 1980, pp. 28-43.

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17 states had spent more than $6.3 million (Mick, forthcoming). This may very well signify that such expenditures are increasing dramatically. Few would doubt it. In fact, of the 14 states reporting expenditures in both 1980 and 1985, spending increased over the period by $2.1 million, or 58.6 percent.

Cities are also mounting major programs to attract foreign direct investment. Atlanta, Miami, New Orleans, Seattle, and San Antonio are among the cities that have sent missions abroad. Some cities have even set up international development offices and overseas offices to facilitate investment and trade. In 1980, 28 states were represented in Europe "by state offices, regional commissions, port authority offices or consultants" and another 22 had offices or representation in Japan (Kline, 1983, p. 60). Today, there are 42 state and port authority offices in Japan, alone, and four more states plan to set up offices soon (Kyle, 1986).

3.2 Linkages and Foreign Direct Investment

With all the attention given to attracting foreign investors in recent years, it is a wonder that so little attention has been given to evaluating the impact of foreign investors on the local economy. Similarly, little research has been done to suggest whether the expenditure of public funds for attracting these firms is worthwhile. An important question involves whether the behavior of foreign-owned firms is similar to that of domestic-owned firms. Do they integrate their production into the local economy in the same way domestic firms do, generating similar local multipliers based on the expansion of local purchases and sales of output? Or do they tend to, as is often

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suspected, import more of their manufacturing inputs, selling more finished goods--reducing the amount of processing activity, value-added output, and employment generation?

These relationships are often specified in terms of "linkages," a concept derived from Leontief input-output modeling. Linkages refer to the notion of interdependence among industrial sectors of the economy. In the input-output model of the economy, changes in production or output in one industry influence demand or inputs in another industry or sector of the economy. Forward linkages refer to the economic activity that occurs in one or a number of industries as a result of the purchases of the output from another. Backward linkages are simply the same relationships in the converse--economic activity that occurs in one industry as a result of its output being purchased by others.[20]

If the linkages for foreign-owned firms are similar to those for domestic-owned firms, we would expect that the basic multiplier effects of a foreign investment would be the same as those of a domestic investment. If the linkages are different, the resulting multipliers will be either stronger or weaker in terms of their capacity to increase employment and output in the local economy.

This chapter will confine itself to investigating the first-order material linkages generated by foreign direct investments in

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[20]This discussion of "linkages" derives from: Hirschman, Albert 0. The Strategy of Economic Development, Yale University Press, 1964.

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manufacturing.[21] As such, there are two concerns. First, we wish to assess the magnitude of geographic linkages generated by foreign manufacturing investments to find out how well they are integrated into the local economy. Second, we wish to compare these linkages with those generated by domestic-owned firms and to test for significant differences. In other words, do foreign-owned firms behave differently than domestic-owned firms?.

By limiting the analysis to first-order material linkages, the resulting analysis is at best incomplete. For instance, one is unable to say whether foreign-owned firms hire more workers, an important backward linkage, than domestic firms.[22] Also, it is impossible to assess the net impact to the local economy of production generated beyond the initial point of sale of firm outputs (first order forward linkages) or production supported beyond the initial point of input purchases (first order backward linkages). In other words, most of the input-output "chain" or "webb" is left unexamined. Even so, the question of first order linkages is a good place to begin this type of analysis, given the difficulties of obtaining this kind of data.

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[21]There are other ways of assessing the worthiness of foreign investments (i.e., a full input-output analysis considering first-order and n-th order material and non-material linkages, or a cost-benefit analysis).

[22]This problem derives from the sample source and concern that large foreign-owned firms were better represented than smaller ones.

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3.3 Literature and Previous Research

It has been suggested that foreign-owned plants have fewer backward and forward ties to the local economy than do domestically-owned plants (Scott, 1983, p. 15). Scott says that "domestic ownership seems to be associated with local linkage, and foreign ownership with non-local linkage" (Ibid, p. 15). However, the studies on which the contention is based all have dealt with foreign-owned firms in other countries--not the U.S. Also, as Scott observes, the evidence is mixed. Some studies have supported the idea, others have not.

Much of the other related literature deals with the import/export propensities of multinational corporations (MNC's), and not specifically with the operations of foreign-owned firms in the U.S. (see Hood and Young, 1979, and Newfarmer, 1983). However, some generalizable thoughts emerge from this literature. First, the greater a firm's reliance on imports of components for assembly, or other inputs, the smaller is thought to be its "linkage with the local economy." It supports fewer local supply-oriented firms and jobs than does a firm that makes more purchases locally. Because of this, its contribution to local economic development is smaller. Second, and on the other hand, the more export-oriented a firm is, the greater is the economic return to the local economy, to the extent that new jobs are created and returns are remitted locally.[23] Third, if a firm is substantially import-oriented,

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[23]This idea primarily derives from the "export base model" of economic development--the notion that "the economic growth of a region...depends upon exogenous demand," or "whether a region grows or declines and" its rate of growth are "determined by how it performs as an exporter to the rest of the world." (Bendavid-Val, 1983, p. 81)

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while significantly less export-oriented, then the establishment may be engaging in a practice known as import-substitution. When import-substitution takes place, firms are primarily in the business of selling imported goods or marginally-transformed import goods in the local economy.

One authority on multinational corporations, Newfarmer (1983), suggests that subsidiaries of foreign-owned firms may have a higher propensity to import that domestic firms, even among firms in the same industry. There are many reasons for this behavior. Local inputs may be risky in terms of availability and quality. Foreign parent firms profit on exports to captive subsidiaries; transfer pricing may aid this strategy. Costs may be different for foreign producers owing to the economies of scale afforded vertically integrated firms. Wilkins (1979, p. 124) suggests that while any propensity to import goods from abroad on the part of foreign-owned firms may have negative balance of payments effects, this yields no specific consequences for states. She also comments (1982, p.45):

> It has been suggested that foreign investment may have a smaller multiplier effect than domestic. . . investment, because of foreign investors' trade. . . practices. . . . Compared with domestic investors, foreign investors seem more apt to export and to have a keener perception of foreign market potentials. . . . There is no evidence that foreign investors in manufacturing in Florida import more than there domestic counterparts.

On the other hand, Hein and LaMattina (1976, p. 3) argue that "foreign-owned manufacturing firms in the United States, as a group, are not export oriented, but concentrate heavily on the U.S. market." They also say that "foreign-owned firms. . . obtain their supplies

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predominantly on the domestic market, i.e., from other U.S.-based firms."

With respect to North Carolina, Behrman (1982, p. 147), argues that foreign-owned firms are likely more export-oriented than locally-owned firms, but cites the absence of data needed to verify this. Using gross output multipliers from an input/output model for South Carolina and knowledge of the sectoral distribution of foreign direct investment in the state, Arpan (1982, pp. 181-182), has tried to find out if foreign firms are concentrated in high multiplier industries. His results have generally been inconclusive.

Data collected by the U.S. Department of Commerce's Bureau of Economic Analysis (BEA), also shed some light on the question of import/export propensities of foreign vs. domestic-owned U.S. firms.[24] For instance, the BEA reports that foreign-owned firms imported $36,985 dollars of merchandise (raw materials, components, and other goods) per worker in 1984, while the equivalent figure for domestic-owned firms was only $2,240. These figures are for all industries. For manufacturing, foreign-owned firms imported $16,674 per employee; unfortunately, it was not possible to obtain an estimate for imports of domestic manufacturers. Nonetheless, these data suggest a high import propensity

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[24]Data on employment, imports and exports of foreign-owned firms was taken from: Foreign Direct Investment in the United States; Operations of U.S. Affiliates of Foreign Companies: Preliminary 1984 Estimates, Bureau of Economic Analysis, U.S. Department of Commerce, October, 1986. Data on imports and exports of domestic firms were taken from: Statistical Abstract of the United States: 1986, 106th edition, U.S. Bureau of the Census, Washington, D.C., 1985; and employment data were taken from: National Income and Product Accounts Tables, Survey of Current Business, Vol. 66, No. 7, U.S. Dept. of Commerce, Bureau of Economic Analysis, July 1986, pp. 65-66.

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for foreign-owned firms. In the case of exports, I found that foreign-owned firms exported $20,750 per worker in 1984, while U.S.-owned firms exported only $1,548 per employee. However, the difference between the export propensities of foreign-owned and domestic manufacturers was not nearly so great. Foreign-owned manufacturers exported $11,654 per employee, while domestic-owned manufacturers exported $8,733 per worker--a sign that foreign-owned manufacturing firms are somewhat more export-oriented, though not greatly.

Little previous research has evaluated the domestic-U.S. linkages of foreign-owned investments. Schaffer (1982, p. 70) says that the "gathering of substantial primary data" is first necessary. However, he concedes, "The answers are important to the ideal analysis, but they are also politically sensitive and almost impossible to obtain, even with a court order." There is one published case in which this kind of primary data has been collected from foreign-owned firms in the U.S. A single domestic survey-based study suggested in 1984 that foreign-owned firms in Illinois are not significantly different than domestic firms in terms of their "first round" material linkages (O'Huallachain, 1984, pp. 241-242).[25]

O'Huallachain's research was conducted as a mail survey of a sample of 184 foreign-owned firms in Illinois. Domestic firms were not surveyed. Instead, O'Huallachain relied on estimates of domestic firm

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[25]"First round," or first order backward linkages involve the transactions for firm inputs between a business or manufacturing establishment and its immediate supplier. First order forward linkages involve the the transactions that represent the transfer of output from the firm to other establishments or consumers, for further processing or final use.

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linkages derived from prior studies. Follow-up for nonresponse was conducted via telephone and in-person visits. O'Huallachain apparently netted little success for these efforts; his usable responses amounted to 33, a response rate of only 17.9 percent. In this case, Schaffer's contention that primary data are almost impossible to obtain was upheld. Furthermore, the results were prone to significant bias because considerable effort was expended to obtain even this small level of response, and the response represented such a small portion of the sample. O'Huallachain gave the impression that some considerable effort was required to get the little response he managed.[26]

O'Huallachain tried to collect two types of information. First, he attempted to collect data that would allow him to construct ratios of purchases over total purchases and sales over total sales for four different geographic regions: (1) within-state, (2) within-region, (3) within-U.S., and (4) outside-of-U.S. This yielded, in effect, the first

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[26]O'Huallachain's survey was frustrated by a number of problems, not the least of which was a low response rate. To some extent, this may have been a result of asking respondents to verify that they were foreign-owned. O'Huallachain found that a principal reason cited for non-response was the claim of many non-respondents that they were not foreign-owned. There are a number of reasons as to why this might have biased his survey response. Principal among them is that the linkage structure of foreign-owned firms is a politically explosive subject, especially if it is one which involves lesser ties to the local economy. Another problem is that many manufacturers may not be aware that, by Commerce Dept. definition, their firms are considered foreign-owned. O'Huallachain also found that many firms considered the information he requested to be confidential. Other than the potential for bias, another significant problem with O'Huallachain's survey was that he did not collect data for domestic-owned firms; rather, he relied on potentially dissimilar data from previous studies of domestic firm linkages. An example of this dissimilarity was the comparison of Philadelphia-area domestic-firm linkages with Illinois foreign-firm linkages; in fact, the regional and local economies may have little in common. Another problem was that the temporal frames of reference were not identical. For example, he compared 1984 linkages for foreign-owned firms with 1969 linkages for domestic-owned firms.

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order forward and backward linkages. Second, he attempted to gather data on the determinants of those linkages for use in an exploratory analysis, the purpose of which was to identify firm characteristics that may be determinants of linkages.

Unfortunately, there are no other recorded attempts to study foreign-firm linkages in the U.S. O'Huallachain's work may be the only example, but it is a reasonable starting point for constructing a meaningful survey and performing additional analysis.

3.4 Research Methodology

The research questions and investigative methods used here are similar to those of O'Huallachain, with the exception that domestic firms have also been surveyed in order to perform an analysis based on firm-ownership. While O'Huallachain sampled foreign-owned manufacturing firms located in Illinois, foreign and domestic-owned manufacturing firms operating in Texas have been surveyed for this analysis.

Texas was a convenient unit of analysis for a number of reasons. First, Texas has gained the largest share of foreign-owned firms in the Southwest and presents a large population from which to sample. Second, by surveying foreign firms located in a region different from the one in which O'Huallachain performed his research, it was hoped that information could be developed which would provide interesting contrasts and comparisons. Lastly, Texas offered convenience in that the research was conducted from this location.

In all, 341 foreign-owned firms were identified for inclusion in

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the foreign firm sample, and a similar number were selected for the domestic-owned firm sample. [See Appendix B for a detailed discussion of the sampling methodology.]

3.4.1 First Order Linkages

The primary objective of the survey was to determine if foreign-owned manufacturing firms in Texas differ from domestic-owned manufacturing firms in terms of first-order forward and backward linkages. Indeed, the literature review, as cited above, revealed that this might be the case. As such, the intent was to collect information which could be used to calculate first-order forward and backward linkages as defined by Hirschman (1958):

$$L^b = M_i / Z_i$$

where L^b is the backward linkage, or ratio of material inputs purchased from within the region, M_i, to the value of all its purchases of material inputs, Z_i, and:

$$L^f = W_j / X_j$$

where L^f is the forward linkage, or ratio of the value of sales of all material outputs to other establishments within the region, W_j, to the value of all sales of material outputs.

Because the forward and backward linkages, as described here, are defined as ratios, it was not necessary to collect actual financial data from the firms--percentages of purchases and sales sufficed.[27]

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[27] O'Huallachain had asked for actual sales and purchase figures in dollar terms, possibly increasing nonresponse problems by doing so.

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An attempt was made to calculate first-order backward and forward linkages at a local (Texas) level, a regional level, the national level, and at the international level. (See the sample survey questionnaire attached as Figure B-1 in Appendix B.) To obtain this information for backward linkages, the percentage of the firm's total purchases (at the surveyed location) or transfers of material goods from other businesses or units of the firm located in the following geographic areas was requested (See Question 2, Figure B-1 in Appendix B.):

1. Texas,
2. Other States Bordering or Adjacent to Texas (signifying local intrastate or regional trade),
3. The United States.

To calculate forward linkages (see Survey Question 3, Figure B-1 in Appendix B), the percentage of the firm's total sales or transfers of material goods (from the surveyed location) to other businesses or units of the firm was also requested for the three regions identified above.[28]

3.4.2 Stage-of-Processing and Intersectoral Dependence

Chenery and Watanabe (as discussed in Hirschman, 1964, pp. 105-109) have set up a classification scheme for manufacturing based on the sectoral interdependence of establishments, expressed through both sales and purchases. Hirschman uses these categories to highlight the

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[28]The U.S. linkages would also provide the information needed to calculate the same information for transactions outside of the U.S.

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importance of high sectoral interdependence as an industry characteristic which may spur greater economic development. Since backward industry interdependence is more likely to spur economic development than forward (Ibid, p. 107), Hirschman ranks the importance of various industries, characterized by their forward and backward interdependence as follows:

- "Intermediate Manufacture"--Characterized by high backward and forward industry interdependence.
- "Final Manufacture"--High backward industry interdependence and low forward industry interdependence.
- "Intermediate Primary Production"--Low backward industry interdependence and high forward industry interdependence.
- "Final Primary Production"--Backward and forward industry interdependence are both low.

In this analysis, this interdependence classification scheme has been extended to the firm, using information gathered on stage-of-processing of both inputs and outputs from the survey. Firms engaged in "intermediate manufacture" would be characterized by partly processed inputs and outputs, suggesting a high degree of inter-firm dependence. Those engaged in "final manufacture" would utilize partly processed inputs, characterized by a high level of backward firm interdependence, and sell finished output or goods, with low forward firm interdependence owing to the the immediate servicing of final demand. "Intermediate primary producers" would be those processing crude or raw inputs, characterized by low backward firm interdependence, and selling partly processed output. Lastly, "final primary producers" would be those purchasing crude inputs and selling finished outputs.

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In applying this schema to foreign-owned and domestic-owned firms, no a priori hypotheses were entertained. Rather, the intention was to determine whether firm ownership was a useful category for assessing the economic development potential of firms.

3.4.3 Firm Characteristics and Linkages

Additional survey questions were designed to assess the employment size class of the firm, the birth characteristics of the firm (whether the existing business was acquired or a start-up), the age of the firm (the length of time the firm/plant has been operating), the stage of processing of inputs when purchased, the stage of processing of outputs when sold, whether the firm was part of a multi-establishment operation, and where other manufacturing affiliates were located (see Survey Questions 4-7 and 9, Figure B-1 in Appendix B). An additional question requested the firm to identify the 2-digit SIC in which it was operating (see Survey Question 8, Figure B-1 in Appendix B). This question was an attempt to confirm the establishment's industry of operation--which was known in almost all cases.

These factors were treated as categorical variables, in an attempt to statistically assign significance to differences in linkages based on firm ownership. To assess the significance of linkage differences across ownership by categorical variable, the null hypothesis for testing purposes was that the two populations, represented by the two samples, were identical:

$$H_0: p_1-p_2=0$$

The variable "p" is a population mean for a population defined

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by a unique categorical variable trait. The alternate hypothesis, was that the populations were different, based on a selected categorical trait.

Through the survey, it was hoped that answers to the following kinds of questions could be developed:

- Are foreign-owned firms different than domestic firms in terms of linkages created? . Evidence cited earlier suggests that foreign-owned firms are probably less dependent on the local economy for inputs than domestic-owned firms, especially considering that foreign-owned firms have a greater propensity to import than domestic firms. Also cited was their greater propensity to export, signifying the possibility of less reliance on the local economy for sales of output.

- Do foreign-owned firm linkages differ on the basis of nationality? A great deal of anecdotal evidence suggests that this may be the case, especially a Japanese tendency to invest in import-dependent, assembly manufacturing.

- Are linkages different depending on whether the firm was acquired or was a new plant startup? The testable hypothesis was that purchase of an existing, U.S. business would be less likely to involve an outsourcing manufacturing strategies than a new plant startup would.

- Are linkages different depending on the age of the firm or investment? Given the proliferation of trade barriers in recent years, one might expect that more recent foreign investments would be especially likely to demonstrate skewed patterns of input outsourcing vis a vis their domestic counterparts. Also, Hein and LaMattina (1976, p. 3) suggest that imports may play an important role among more recently established foreign-owned companies.

- Are linkages different depending on the size of firm? A variety of literature suggests that smaller firms are more dependent on local economies for inputs and sales of outputs than larger firms (Scott, 1983, p. 14).

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- Are linkages different depending on the sector of the firm (e.g., "high tech" vs. other industries, durables vs. nondurables, etc.)? Admittedly, an explicit "a priori" hypothesis was lacking here. Rather, information was being sought which might suggest the best industry-ownership firm characteristics to target for economic development purposes.

- Are linkages different depending on the stage of processing of a firm's inputs and outputs (i.e., crude, intermediate, and finished goods)? Again, the approach was an exploratory one, here, seeking information useful to economic development planners.

Implicit in these questions was a concern with the advisability of targeting foreign direct investments for economic development purposes, rather than domestic-owned investments, as well as a concern that the wisdom of doing so might also depend on other firm characteristics, in addition to ownership.

3.5 Analysis of Survey Response

63 useable foreign firm and 87 useable domestic firm responses were received. The overall response rate was 22.0 percent, 18.5 foreign and 25.6 domestic. Considering that no follow-up for nonresponse was conducted, the response may be considered favorable compared to

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O'Huallachain's.[29]

Table 3-1 summarizes the mean responses for foreign and domestic firm linkages broken out by various categories of firm or industry.[30] Of interest, perhaps, is that only 55 out of 63, or 87 percent, of the foreign respondents chose to provide information on the percentage of inputs purchased locally. The equivalent figure for domestic firms was 85 out of 87, or 98 percent. This may highlight the special sensitivity of foreign firms to publicly divulge this kind of information and point out a potential source of bias in the statistical analysis which follows.

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[29]The response rate may not really indicate that foreign firms were less willing to respond than domestic firms. At least 70 of the 341 sampled foreign firms were not actually contacted, mostly because the addresses were incorrect or the establishments had moved and the postal forwarding orders were expired. These surveys were returned unopened by the Post Office. If these 70 are discounted, then the foreign firm response rate is boosted to 23.3 percent. Only 15 domestic firm surveys were returned unopened and unforwardable by the Post Office. If these are discounted, then the domestic firm response rate is 26.8 percent--not tremendously different than the foreign firm response. One significant problem in the survey responses occurred. Questions 2 and 3 of the survey were widely misinterpreted and responses were spotty except for the part of each question asking for the proportion of Texas purchases or sales. Rather than attempt to recontact every respondent, only the portion of each of the questions that dealt with Texas (local) linkages was used.

[30]Table 3-1 shows a number of firm/industry categories. The "high tech" category is defined by SIC and taken from the Congressional Budget Office Report, Federal Support for High-Technology Industries, published in June of 1985. Chemicals, Petroleum Processing, and Rubber/Plastic manufacturers are aggregated to boost response for the industry-cell and because they are related industries. Machinery, Electronics, Transportation Equipment, and Instruments were aggregated for the same reasons, as were Primary and Fabricated Metals.

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Table 3-1: First Order Linkages For Foreign and Domestic Firms, by Ownership, Industry and Type of Firm

		% INPUTS PURCH. LOCALLY		% OUTPUTS SOLD LOCALLY	
	TYPE	N	MEAN	N	MEAN
ALL INDS/FIRMS	DOMESTIC	85	53.1	83	46.3
(BY OWNERSHIP)	FOREIGN	55	52.1	62	49.2
	GERMAN	11	53.2	13	45.1
	FRENCH	10	42.6	10	59.8
	BRITISH	9	48.8	10	44.0
	CANADIAN	9	58.1	10	53.1
	JAPANESE	5	67.4	8	53.6
DURABLE GOODS	DOMESTIC	46	48.4	44	48.4
	FOREIGN	23	44.7	27	54.7
NONDURABLE	DOMESTIC	39	58.7	39	44.0
	FOREIGN	32	57.4	35	44.9
HIGH TECH	DOMESTIC	50	54.6	49	43.9
	FOREIGN	31	48.3	33	38.1
NON-HIGH TECH	DOMESTIC	35	51.0	34	49.8
	FOREIGN	24	56.9	29	61.9
CHEM/PETR.PROC.	DOMESTIC	36	57.7	36	43.0
& RUBBER/PLAST.	FOREIGN	26	54.0	28	41.6
PRIM. & FABR.	DOMESTIC	15	41.8	14	40.2
METALS	FOREIGN	6	45.7	9	56.8
MACH/ELECTRON.	DOMESTIC	18	47.0	17	47.4
TRANSP/INSTRUM.	FOREIGN	10	36.7	10	34.3

(Continued)

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Table 3-1 Continued

		% INPUTS PURCH. LOCALLY		% OUTPUTS SOLD LOCALLY	
	TYPE	N	MEAN	N	MEAN
NEW PLANTS	DOMESTIC	47	53.0	46	45.7
	FOREIGN	29	53.7	33	40.0
ACQUIRED PLANTS	DOMESITC	33	51.0	32	47.2
	FOREIGN	23	51.6	26	59.5
FIRMS ESTAB.	DOMESTIC	55	50.1	52	47.5
BEFORE 1976	FOREIGN	27	52.4	30	47.1
YOUNGER FIRMS	DOMESTIC	30	58.5	31	44.1
ESTAB. 1976+	FOREIGN	28	51.7	32	51.1
LARGE FIRMS	DOMESTIC	37	48.2	35	53.3
(100+ EMP.)	FOREIGN	33	53.3	35	40.6
SMALLER FIRMS	DOMESTIC	48	56.9	48	49.9
(100 OR LESS)	FOREIGN	22	50.3	27	60.3
MULTI-ESTAB.	DOMESTIC	50	53.2	49	44.7
	FOREIGN	42	48.1	47	47.6
SINGLE-ESTAB.	DOMESTIC	35	53.0	34	48.7
	FOREIGN	13	64.9	15	54.2

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The mean proportions of foreign and domestic firm linkages were tested, as well as the variances of the reported proportions, across categories in order to determine if significant differences existed. In fact, significant differences were not found. Linkage means were not found to differ, nor were the variances of the reported distribution of linkages. Hence, significant differences were not found in domestic and foreign firm linkages.

Table 3-2 shows the results for the general test of all firms, foreign and domestic, where INPTEX is the proportion of inputs purchased in Texas and OUTTEX is the proportion of output sold in Texas:

A subsequent analysis showed that linkage responses were not normally distributed, and that further testing was required.[31] This testing produced results similar to those described above.[32]

While statistically significant differences between mean linkages were not found for firms aggregated by foreign or domestic ownership, or any of the set of subcategories shown in 3-1, it is still possible that

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[31]Even if the assumption of normality is forsaken in the t-test, it should still report approximately correct results in a large sample situation. However, some of the categories for analysis did not include enough responses to guarantee reliability.

[32]A nonparametric test, the Wilcoxon Rank Sums test--which does not require a normal distribution in the samples, was selected to test whether foreign and domestic firm linkages were identical. Again, testing across the available categories, no significant differences were found. In the general test, for all firms, a z-score of -0.2634 with PROB $>|Z|=0.8710$ was obtained in the test of backward linkages, indicating no difference between foreign and domestic-owned firms. For forward linkages, a z-score of 0.2802 with PROB$>|Z|=0.7793$ was found, again indicating no difference between firms based on ownership.

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Table 3-2: Test of Equality of Means and Variances for Foreign and Domestic Firm Forward and Backward Linkages

VARIABLE: INPTEX

TYPE	N	VARIANCES	T	DF	PROB > |T|
DOMESTIC	85	UNEQUAL	0.1814	112.5	0.8564
FOREIGN	55	EQUAL	0.1828	138.0	0.8552

FOR HO:VARIANCES ARE EQUAL F'=1.07 WITH 54 AND 84 DF PROB>F'=0.7614

VARIABLE: OUTTEX

TYPE	N	VARIANCES	T	DF	PROB > |T|
DOMESTIC	83	UNEQUAL	-0.4989	124.0	0.6187
FOREIGN	62	EQUAL	-0.5062	143.0	0.6135

FOR HO:VARIANCES ARE EQUAL F'=1.22 WITH 61 AND 82 DF PROB>F'=0.4005

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more disaggregate categories might yield different results. Obviously, the limitations imposed by the characteristics of the survey response make any analysis along these lines rather limited. Nonetheless, the following discussion highlights some of the results of that analysis.

A number of attempts were made to break out linkage responses into various 2-way categorical response tables amenable to Chi-squared testing, which might yield different patterns for foreign and domestic firms. The results in Table 3-3 provide the only evidence that differences may exist, and only for limited circumstances of forward linkages. They suggest that foreign-owned non-high tech firms have somewhat more of an extreme local market orientation (80-100 percent Texas sales) than similar domestic firms. Also, they suggest that foreign-owned non-durable goods producers operate more prevalently than domestic firms in at least a couple of niches: (1) mostly local (Texas) sales (80-100% local sales), and (2) mostly out-of-state sales (0-20% local sales. Similar domestic firms seem to operate more generally in the middle range (20-80% local sales), although the middle range is rather broadly defined. As a result, these differences may not be very meaningful.

In the survey, firms were asked to characterize their inputs as predominantly crude (raw) or processed (semi-finished). The information is of interest because purchase of processed inputs is thought to support greater economic activity and more jobs than purchase of crude or raw inputs, at least over the backward linkage path. Clearly, more economic activity is required upstream to produce processed or semi-finished goods in conjunction with raw goods, than just to produce raw goods. Firms were also asked to characterize their output as predominantly processed

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Table 3-3: Chi-squared Analysis of Foreign and Domestic Firm Forward Linkages

CHI-SQUARED ANALYSIS ON NON-HIGH TECH FIRM

OUTPUT SALES TYPE: FOREIGN OR DOMESTIC

FREQUENCY COL PCT	DOMESTIC	FOREIGN	TOTAL
0-20% LOCAL	10	6	16
	29.41	20.69	
20-80% LOCAL	18	10	28
	52.94	34.48	
80-100% LOCAL	6	13	19
	17.65	44.83	
TOTAL	34	29	63

CHI-SQUARE STATISTIC=5.502 DF 2 PROB 0.064

CHI-SQUARED ANALYSIS ON NONDURABLE GOODS FIRMS

OUTPUT SALES TYPE: FOREIGN OR DOMESTIC

FREQUENCY COL PCT	DOMESTIC	FOREIGN	TOTAL
0-20% LOCAL	12	16	28
	30.77	45.71	
20-80% LOCAL	22	11	33
	56.41	31.43	
80-100% LOCAL	5	8	13
	12.82	22.86	
TOTAL	39	35	74

CHI-SQUARE STATISTIC=4.728 DF 2 PROB 0.094

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(semi-finished) or finished (ready for final consumption). Sales of processed rather than finished outputs or products should support more economic activity over the forward linkage path. Again, it is obvious that more economic activity is required downstream to produce finished goods for sale from semi-finished ones, than just to purchase the finished goods.

Performing Chi-squared tests on 2-way response tables of firm ownership versus state of processing (crude vs. processed) for inputs, significant differences between foreign and domestic firms of the following types were found:

1. Multi-establishment firms were more likely to purchase processed inputs if they were foreign owned. 82.6 percent of foreign firms purchased processed inputs as opposed to 58.0 percent for domestic establishments (Chi-square statistic=6.882, DF 1, PROB 0.009),

2. Nondurable goods firms were more likely to purchase processed inputs if they were foreign owned. 77.1 percent of foreign firms purchased processed inputs against only 48.7 percent of domestic firms (Chi-square statistic=6.336, DF 1, PROB 0.012),

3. Chemical-related industries (Chemicals, Petroleum processing, and Rubber/Plastics manufacturers) were also more likely to purchase processed inputs if they were foreign owned. 74.1 percent of foreign firms purchased processed inputs while only 52.8 percent of domestic firms did (Chi-square statistic=2.967, DF 1, PROB 0.085).

Chi-squared tests were also performed on 2-way response tables of firm ownership versus stage of processing (processed vs. finished) for outputs. Significant differences between foreign and domestic firms were

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found for one group, that of durable goods producers. 87.5 percent of foreign-owned durable goods producers sold finished products as opposed to only 66.7 percent for domestic-owned establishments (Chi-square statistic=3.575, DF 1, PROB 0.059). To the extent that the processed inputs used by firms originate locally, local economic development would be enhanced. At the same time, processed outputs sold locally should provide more opportunities for local processing.

Given the earlier discussion, the ideal manufacturers for enhancing local economic development would be those that purchased processed inputs and sold processed outputs, or "intermediate manufacture" producers. These producers leave room for extra processing (and thus, more economic activity) at each end of the linkage path. Producers purchasing crude products and selling finished products, or "final primary producers," leave little room for substantive linkages at either end; they perform all of the processing themselves. Producers that would fill an intermediate economic development role would be those purchasing processed inputs and selling finished output, "final manufacturers," and those purchasing crude inputs and selling processed outputs, or "intermediate primary producers."

Responses were analyzed using this classification schema and the Chi-squared test. Significant differences between foreign and domestic firms were found in two categories: nondurable goods producers and multi-establishment firms. In both cases, foreign firms were more likely to occupy niches as "intermediate manufacturers" and "final manufacturers," and least likely to operate as "final primary" producers. Tables 3-4 and 3-5 show the results of these tests. "TOP" refers to the type of producer, as indicated above. Again, these relationships would

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only hold local economic development value to the extent that inputs were purchased locally and outputs sold locally. Unfortunately, the size of the response will not support further analysis along these lines, so the question remains unanswered.

3.6 Conclusions and Recommendations

No significant differences between foreign and domestic-owned firms in the proportion of local inputs purchased in Texas were found. This essentially confirms O'Huallachain's conclusion about the operations of foreign-owned firms in Illinois, at least for Texas firms. However, potential bias in the foreign firm response for this survey must be acknowledged, as pointed out earlier. Also, additional sample observations, which would provide for analysis with greater industry and type-of-firm detail, might force the modification of this conclusion with respect to certain sectors.

Differences in the the proportion of output sold in Texas for foreign vs. domestic-owned firms were found for nondurable goods producers and non-high tech producers, but any conclusions would have to be drawn carefully, given the level of industry/sectoral aggregation and the way in which the output categories were constructed.

Foreign owned multi-establishment firms, nondurable goods producers, and chemical/petroleum/plastic-related industries were found to purchase more processed inputs than similar domestic owned firms, thus enhancing the quality or economic development potential of backward linkages. Foreign durable goods producers were found to sell more finished output than domestic producers of the same type. This

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Table 3-4: Chi-square Analysis of Nondurable Goods Producers

TABLE OF TOP BY TYPE

TOP	TYPE(FOREIGN OR DOMESTIC)		
FREQUENCY COL PCT	DOMESTIC	FOREIGN	TOTAL
Final Primary	13	3	16
	33.33	8.57	
Intermediate Primary	7	5	12
	17.95	14.29	
Final Manufacture	13	14	27
	33.33	40.00	
Intermed. Manufacture	6	13	19
	15.38	37.14	
TOTAL	39	35	74

STATISTIC	DF	VALUE	PROB
CHI-SQUARE	3	9.009	0.029

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Table 3-5: Chi-square Analysis of Multi-Establishment Firms

TABLE OF TOP BY TYPE

TOP	TYPE(FOREIGN OR DOMESTIC)		
FREQUENCY COL PCT	DOMESTIC	FOREIGN	TOTAL
Final Primary	13	2	15
	26.00	4.55	
Intermediate Primary	8	5	13
	16.00	11.36	
Final Manufacture	19	26	45
	38.00	59.09	
Intermed. Manufacture	10	11	21
	20.00	25.00	
TOTAL	50	44	94

STATISTIC	DF	VALUE	PROB
CHI-SQUARE	3	9.551	0.023

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would have the effect of weakening the economic development potential of the forward linkages for these producers.

Foreign owned multi-establishment firms and nondurable goods establishments were also found to have a far greater proportion of "intermediate manufacture" operations than similar domestic producers, offering better forward and backward linkage potential. They also had the least proportion of "final primary production," which offers the least forward and backward linkage potential. However, meaningful conclusions require additional response and far more industry/sector detail than is available here.

In sum, foreign firms may offer some advantages over domestic firms in terms of local economic development potential in some rather specific circumstances. In most circumstances, however, they seem to differ little from domestic-owned firms in the linkages established and economic development potential of those linkages. At least, this is what one may conclude if the survey results are accepted without further investigation.

There are a number of reasons for questioning this conclusion. Most important are the established propensities of foreign-owned firms to import and export more than domestic-owned firms cited in the earlier literature. Even discounting the literature which establishes this, data reported by the Bureau of Economic Analysis demonstrate this (see previous discussion). While a higher proportion of out-of-country purchases and sales for foreign-owned firms does not require that within-Texas purchases and sales of foreign-owned firms be diminished, it suggests that they may be reduced. Or, they may be reduced elsewhere

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in the U.S. Unfortunately, the survey was unable to provide an answer to this question.

Also, industry/sectoral considerations may make foreign-owned producers more similar to U.S.-owned producers in Texas than elsewhere. For instance, a large portion of the sample--and response--is represented by petrochemical and petrochem-derived production, that is: petroleum processing, chemicals, and rubber and plastics.[33] The nature of these industries is such that the input and output transactions of these establishments has more to do with access to local raw materials and markets than would be true for other industries--things that will not likely change with ownership.

Furthermore, the low level of response makes it impossible to assess the representativeness of the response. The response may well be biased in some unknown, unmeasurable way.

While more information needs to be developed to clarify any economic development potential of foreign owned firms, communities in the state should at the same time re-evaluate their efforts to attract foreign manufacturers. Foreign firms may, in general, offer no special advantages over domestic-owned establishments. In fact, domestic-owned manufacturers may, in most cases, provide the same economic development potential. Given the level of expenditures being committed to foreign firm attraction, this is an important consideration for economic development planners.

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[33] 45.2 percent of the foreign firm response and 43.4 percent of the domestic firm response is derived from this sector.

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Chapter 4

The Implications of Foreign Direct Investment in the U.S. Auto Industry

4.1 Background

Foreign direct investment in the U.S. auto industry is one aspect of the way in which global competition is altering U.S. industry. In the auto industry, this competition is changing the way cars are made, as well as where they are made, with serious implications for the future of the U.S. industry, employment, and linked sectors of the economy. Foreign direct investment in the U.S. auto industry is fundamentally a trade-related phenomenon. After several years of protectionist pressures and moves on the part of the U.S. government, foreign-owned auto assembly is locating in the U.S., while imports of cars and components are on the rise. The response of U.S. automakers has been downsizing and restructuring to meet the changing market realities, and outsourcing of cars and components is increasingly a favored strategy.

Currently, auto imports have captured about a quarter of the U.S. market. While imports are predominantly from Japan, the loss of U.S. market share is expected to worsen as imports from South Korea,

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an assortment of newly industrializing countries, as well as eastern-bloc nations, gain strength. Hoping to blunt protectionist pressures, Japan's Honda, Nissan, and Toyota have all recently located assembly plants in the U.S., currently producing 335,690 cars (Wall Street Journal, 1987, p. 1) Germany's Volkswagen and France's Renault (through American Motors) also have assembly facilities in the U.S., and South Korea's Hyundai is planning assembly in Canada. By 1990, Japan's Mazda, Mitsubishi, Isuzu, Subaru, Suzuki, and Daihatsu will be producing in the U.S. or Canada (Ibid, p. 1).[34] It is estimated that, by 1990, the U.S. "assemblies" of foreign-based auto producers will reach two million units. Another 3.5 million units will be imported or "outsourced" by GM, Ford, and Chrysler. Altogether, foreign-based and foreign-owned production will account for 60 percent of the cars sold in the U.S. (Dyer, et. al., 1987, p. 2).

The implications of this forecast are troubling, not just for the industry, but also for the economy at large. Perhaps more so than any other segment of U.S. manufacturing, the auto industry has important linkages to other manufacturing industries (Conversation with Glasmeier, 1987). The result is that significant loss of U.S. production or major changes in input sourcing have significant impacts on other manufacturing industries.

But it is more than just a worrisome forecast. A continuing a loss of production capacity and employment is taking place right now, not just in the U.S. auto industry, but in ancillary industries and

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[34]The U.S. and Canada signed an agreement in 1965 which, for purposes of production, makes the two countries virtually an integrated auto market.

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services--a trend that only seems to worsen with each passing month. Just a few months ago, General Motors announced the closing of 11 plants, with the potential to affect 10 percent of its U.S. production and to idle 29,000 workers--mostly in the coming year (Prokesch, 1986, p. 1). More restructuring is on the way. The UAW estimates that 120,000 jobs will be eliminated in the auto industry over the next five years (Feder, 1986, p. 23). Harvard researchers estimate a loss of 140,000 production and assembly jobs at GM, Ford, Chrysler, and AMC between 1983 and 1990 (Dyer, et. al., 1987, p. 305). 215,000 jobs of hourly workers have already been lost since 1978 (Prokesch). With increased outsourcing and decreased domestic production, 1,000 supplier plants were already closed by 1982 with a loss of 400,000 to 500,000 jobs in supplier industries (Dyer, et. al., p. 151). According to the report of the Harvard Business School Project on the Auto Industry and the American Economy (Ibid, p. 2):

> Besides the hundreds of thousands of jobs and billions of dollars in investment the U.S. automakers are continuing to lose, the effects of change will ripple outward to suppliers and dealers, to communities and public institutions. Nor will the foreign-based investment in the United States begin to offset this damage. In addition to the direct impact of the lost auto wars, the indirect effects--lost skills, lost investment, lost opportunities--will prove adverse for years to come.

Foreign direct investment in the U.S. auto industry provides a good case for analysis because of the industry's linkages to the rest of the economy and its implications for the U.S. economy and U.S. workers. In reviewing such investment, this paper will examine the history and role of trade in motor vehicles and foreign investment. It will examine the specific circumstances surrounding each of the major established investments to date, including Volkswagen's, Renault's,

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Honda's, Nissan's, and Toyota's, with the purpose of explaining the trade-related context of such investments. It will also examine the contributions of these investments to management, labor relations, production, and employment in the U.S. auto industry. The discussion will also shed some light on the domestic sourcing patterns of foreign-owned automakers in the U.S. and examine the implications of those patterns.

4.2 Imports and the U.S. Auto Industry

Until the 1950s, there was little import activity in the U.S. auto market. In part, this was a legacy of the tariff wars of the 1930s. In fact, the pre-World War II American tariffs were not significantly reduced until the 1950s. In part, it also owed to the devastation of European and Japanese production capacity during the war, although the Japanese industry had only just begun to develop immediately preceding the war. To some extent, it was also the result of successful production strategies employed by the major oligopolistic auto producers in the U.S. (GM, Ford, and Chrysler).

However, after the mid-1950s, European exports to the the U.S. market grew rapidly. From 1955 to 1959, European imports grew from less than one percent of the U.S. market to over 10 percent (Altshuler, et. al., 1984, p. 25). Typified by the Volkswagen Beetle, European imports were concentrated at the low and intermediate segments of their lines. Aided by decreasing tariffs, their success owed largely to the fact that U.S. producers had ignored the low end of the market, preferring large cars with higher markups.

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The success of European products in the U.S. market sent a strong warning to U.S. automakers, who rushed out a number of "compact" cars to compete at the low end of the market, including the Ford Falcon, the Dodge Dart, and the only U.S. produced "subcompact" of the era, the ill-fated Chevrolet Corvair. By 1963, the import share of the market had dipped back down to 5 percent, and U.S. automakers were up scaling their compact offerings through resizing and add-on equipment (Ibid, and Halberstam, 1986, p. 436). The Europeans, in turn, responded by recapturing market share. By 1970, the European share of the market, primarily as a result of Volkswagen's success, was over 10 percent again. Volkswagen's results had largely been built up on the sale of a few low-end models, mainly the Volkswagen Beetle, which changed little over time and offered tremendous production economies of scale.

The Japanese entry into the U.S. automobile market was a late and inauspicious one. There were a number of reasons for this, including a lack of pre-war production experience and technical know-how. Little auto production capability had been built up prior to or during World War II and production facilities remained small and backward after the war. Nissan's first post-war passenger car, in 1947, was almost identical to a 1936 model. Toyota's 1947 Toyopet was a passenger car mounted on a truck chassis (Dyer, et. al., 1987, p. 106). By 1954, Japanese auto production had reached only 14,500 units compared to 5.5 million produced in the U.S. (Ibid, p. 118). When Toyota moved to export to the U.S. market in 1958, it's offering was "laughingly rejected" (Ibid, p. 124). Japanese offerings through the mid-1960s attempted to target the market for small, inexpensive cars, but remained unsuited to U.S. operating conditions and sold few units.

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While the Japanese entry into the U.S. market was delayed, the Japanese were quickly developing developing technical expertise and advanced production systems. Japan's MITI was highly influential at this time. In fact, one of the most important moves in the development of the industry was MITI's limitation on imports, imposed through foreign exchange restrictions (Dyer, et. al., 1987, p. 118). The government also offered an 80 percent net tax deduction on export earnings. From 1956 to 1966, MITI tried to introduce simplified design, cost reductions, and scale economies in the auto parts industry, through a program of mergers, consolidations, low cost financing, and promoting the coordination of research and development (IBID, p. 119). The auto supply industry was also rationalized into a set of families or industry associations tied closely to major auto producers. MITI spent heavily on R & D for the auto industry and encouraged major capital investment by granting it "strategic" importance.

Tremendous growth in the Japanese industry provided a lure for new entrants; between 1958 and 1963, the number of automakers increased from five to 11, with Honda being the last entrant in 1963 (Ibid, p. 24). This prompted a new effort on the part of MITI to rationalize the industry through consolidation. However, many newer entrants resisted, pursuing link-ups with U.S. automakers instead. Ford, GM, and Chrysler were looking for Japanese joint ventures in 1967 (Encarnation, 1987, p. 25). MITI approved Chrysler's purchase of 35 percent of Mitsubishi in 1971; link-ups between Ford and Toyo Kogyo (Mazda) and GM and Isuzu soon followed (Dyer, et. al., p. 127). These link-ups provided a new source of capital for the Japanese auto industry, while management of foreign participation in the agreements by MITI limited U.S. access to the Japanese market. Furthermore, these link-ups

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never provided for a significant transfer of managerial control to U.S. producers. From 1954 to 1972, Japanese auto production increased from 14,500 to 4 million cars, with 1.4 million destined for export.

By the late 1960s, Japanese cars sold in the U.S. were gaining a reputation for innovative design and quality. Nissan's 1968 Datsun 510 was a good example of the new trend. Patterned after the BMW 1600, a sporty European sedan, the car was priced at $1800 or about a third of the price of the BMW (Halberstam, 1986, p. 442). Nissan's success blunted Volkswagen's up-till-then continually increasing share of the import market. Toyota's Corolla, introduced specifically for the American market became one of the world's most successful auto lines (Friedman, 1983, p. 366). By 1968, the Japanese surpassed the West Germans to become the second largest producer of autos in the world (Halberstam, p. 442). Over the next five years, Volkswagen saw its share of the import market drop from 62 to 46 percent, attributable in large part to the new Japanese competition (Ibid).

By 1970, imports had captured 10 percent of the U.S. market again, and the U.S. automakers rolled out an assortment of compact, low-end cars including Ford's Maverick and Pinto and GM's Vega (Halberstam, p. 437). Other large models were "stripped" in an effort to compete on the basis of standardization and price (Friedman, p. 366). This effort to compete with imports on the basis of size, standardization, and price may not have been unreasonable given Volkswagen's success until 1968. However, Japanese producers were pursuing a different strategy, taking market share from both Volkswagen and the U.S. producers at the same time. This hitherto undiscussed aspect of the new Japanese competition in the U.S. market was an aggressive market

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differentiation strategy (Friedman, p. 366). Rather than simply competing on the basis of economy, Japanese producers were selling a range of products which also offered significant variation in performance, styling, and technology. The strategy paid off. By 1973, imports had gained 15 percent of the U.S. market, with Japanese producers capturing more 40 percent of the import market (Altshuler, p. 25).

While the 1973 oil shock did not usher in a dramatic increase in import penetration of the U.S. market, sales did pick up, pushing the import share of the market to almost 18 percent by 1978. European imports, mainly Volkswagen, suffered a great loss of market to the Japanese, who by 1978 had 12 percent of the U.S. market (Ibid). Volkswagen's decision, in 1974, to invest in U.S. production facilities was partly a response to its profound market losses here (Hood and Young, 1986, p. 175). However, in 1979, Japanese imports surged, largely a result of rapidly shifting consumer demand for small, fuel efficient autos, presaged by the Iranian crisis of 1979 and a runup on gasoline prices (Calton and Krumme, 1984, pp. 186-187). In 1979, Japanese imports captured 17 percent of the market (Ibid). By 1981, Japanese import penetration had reached 23 percent (Ibid).

4.3 Protectionism and the U.S. Auto Industry

Already, in 1976, the U.S. government had been prodded into concern over the imbalance in U.S.-Japan auto trade and petitioned Japan for an end to non-tariff barriers which limited imports into Japan to one percent of their market (Dyer, et. al., p. 138). When the U.S. auto industry went into a slump in 1979, concern gave way to crisis. Chrysler almost went into bankruptcy and was only rescued by a $1.5

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billion government backed loan (financed by the Chrysler Loan Guarantee Act of 1979) (Calton and Krumme, p. 191, and Dyer, et. al, p. 173). Ford, Chrysler, and the UAW asked the Carter Administration for protection, but to no avail (Dyer, et. al., p. 273).

Since the mid-1970s, the UAW had been pressing Japanese producers to locate production plants in the U.S. In 1980, Doug Fraser, President of the UAW, personally traveled to Japan to press the issue, but walked away without commitments (Halberstam, pp. 575-579). In the Summer of 1980, Ford and the UAW petitioned the International Trade Commission, under Section 201 of the Trade Act of 1974, for relief from import injury to the domestic auto industry. The other U.S. producers did not join in the petition and in November, the ITC voted to reject the petition, citing other economic factors for the industry slump (Calton and Krumme, p. 192).

The industry's requests for protection were hardly unanimous. General Motors was a vocal opponent of trade restrictions because its 46 percent share of the U.S. market had barely been affected by the import surge, and its program of downsizing was further along than those of the other U.S. carmakers. Also, it was moving toward integrated international production and marketing (Ibid). American Motors' plan for improvement of its 1.6 percent market share was contingent in large part on a production and marketing agreement forged with Renault in 1980 (this amounted to a virtual acquisition by the French producer). Chrysler was hesitant because it had already negotiated a $1.5 billion government-backed loan. Besides, part of its survival strategy included the sale of more captive imports (through its linkage with Mitsubishi), and it was already dependent on the import of drive train components from Volkswagen (Ibid, p. 191).

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The UAW kept up the pressure for protection after the ITC ruling and petitioned Congress for resolutions supporting an orderly marketing agreement with Japanese producers in 1980 and 1981. In January 1980, Honda announced plans for U.S. auto assembly (Calton and Krumme, p. 200). Then in April, Nissan announced plans for light truck assembly in the U.S. (Ibid, p. 201). The U.S. and Japan rejected import restrictions on Japanese auto imports during the bilateral auto trade talks held in May 1980. At the conclusion of those talks, MITI stressed Honda's and Nissan's plans for assembly plants, and indicated that Toyota was considering such an investment (Jiji Press, May 15, 1980). The Japanese government hoped that this and the relaxation of barriers to the import of U.S. autos and auto parts would blunt further protectionist moves. This was not to be the case. By June, the clamor for protectionism in the U.S. induced MITI to ask Japanese producers for informal export restraints (Jiji Press, June 26, 1980).

The MITI action was not enough. The Reagan Administration negotiated a "voluntary" export restraint (VER) with Japan in 1981. The agreement called for a limit on Japanese auto imports to 1.76 million for the year beginning April 1, 1981, an import cut of 7.7 percent over the preceding 12-month period (Altshuler, p. 229). The limit was raised to 1.85 million units for the year beginning April 1984 (Hood and Young, p. 172). When the agreement expired in 1985, Japan and its automakers agreed to continue informal restraints in order to head off continuing protectionist threats from the U.S., although Japan decided to raise its ceiling by 25 percent (Dyer, et. al., p. 139 and Peterson, 1986, p. 35 and Flaherty, 1985, p. 12).

At the same time that VERs have been in effect, the UAW,

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AFL-CIO, auto parts companies, and major industry suppliers such as the steel industry have lobbied extensively for domestic content legislation (Nanto, 1985, p. 42). This has been aimed at tieing auto sales in the U.S. to domestic production as well as reducing outsourcing by U.S. automakers. Needless to say, while some U.S. automakers have given support to the concept, all have opposed the legislation (Ibid). The House of Representatives approved versions of domestic content legislation in 1982 and 1983, but it failed to gain support in the Republican-controlled Senate. The debate over domestic content waned after 1984 with the first arrivals of Japanese producers (Dyer, et. al., p. 200).

4.4 Volkswagen's Decision to Invest in the U.S.

Volkswagen's decision to locate an assembly plant in the U.S. came early on, in 1974 (Dyer, et. al., p. 94). However, it was not until 1976 that a site was selected. Prompted by German inflation and upward pressure on the deutschmark with the collapse of the Bretton Woods agreement in 1973, the retail value of the VW Beetle in the U.S. had increased from $1,799 to $2,895 between 1969 and 1974 (Ibid). Over the same period, VW's share of the U.S. import market fell from 7 to 4 percent--with Japanese producers gaining all of the loss. In 1975, Toyota's sales in the U.S. surpassed Volkswagen's (Negandhi, 1981, p. 39). By 1976, VW sales in the U.S. had fallen by more than half from a 1970 peak of 583,000 units and VW's distribution network was disintegrating as dealers picked up Japanese franchises (Hood and Young, p. 175).

The Volkswagen investment was largely a defensive one,

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designed to prevent further loss in a major export market. Unlike the later Japanese investments, fears of protectionism were not yet a major consideration, although the investment was part of a strategy to improve Volkswagen's prospects for trade. Initially, German trade unions had opposed the project, fearing job losses. Union representatives on the company's board of directors only voted to go along with the plan after receiving assurances that the investment would not contribute to layoffs or plant closings in Germany (Dyer, et. al., p. 95). It was argued that the U.S. investment would continue to require German components (Hood and Young, p. 175). Negandhi (p. 39) describes the benefits sought from a U.S. plant as follows:

1. To reduce the impact of currency fluctuations.

2. To provide management with greater flexibility to react to U.S. market conditions.

3. To reduce shipping costs.

4. To provide some relief to the German employees who were fearful of losing their jobs by using engines and transmissions manufactured in Germany.

Volkswagen purchased a partially built Chrysler facility in New Stanton, Pennsylvania in 1976 for $236 million, with $86 million coming from a state and local incentive packages. The plant was slated to produce the VW Rabbit, VW's mid-1970s replacement for the aging Beetle, with an initial capacity for 200,000 cars and with production to begin in April 1978. Despite being embroiled in early controversy over minority hiring and plans to keep the UAW out of the plant, the plant was seen by VW as a success (Business Week, February 6, 1978 p. 106, Hood and Young, p. 175-176, and Sinclair, 1983, p. 74). In 1978,

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Volkswagen also took over a stamping plant in Charleston, West Virginia, which supplied (until recently) sheet metal parts and stampings for the Pennsylvania assembly plant (Hearing, March 19, 1980, p. 39). In March 1980, VW opened a new plant in Fort Worth, Texas, for manufacturing automobile air conditioners, heating units and other parts (Ibid).

The VW plant in Pennsylvania gained a certain amount of notoriety because of the kinds of incentives that were offered by the state to obtain the investment. The investment decision came at a time of high unemployment and and recession in the U.S., and this prompted an intensive campaign on the part of state and local officials, who were looking for the jobs and tax revenues that a new plant would bring (Negandhi, p.39 and Kline, 1983, p. 65). When Ohio and Pennsylvania were selected as finalists, the governors of both states made last-minute visits to Germany to woo the company (Kline, op. cit.). In the end, Pennsylvania won the competition with a multimillion dollar package of low cost loans, tax relief, and highway and rail improvements that included (Negandhi, op. cit., and Kline, op. cit.):

1. A $40 million loan from the Pennsylvania Industrial Development Authority at 1.75 percent interest for the first 20 years and 8.5 percent for the final 10 years of the loan, with no principal payments for twenty years.

2. A $6 million loan at 8 percent interest from Pennsylvania's school pension fund.

3. Two bond issues, which totaled $25 million, to pay for railroad and highway improvements.

Pennsylvania's Bureau of Employment Security agreed to handle

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recruitment and job screening for VW. The county of Westmoreland, two townships, and two school districts agreed to extensive property tax waivers. Also, the plant site was granted subzone status within the Pittsburgh Foreign Trade Zone, allowing Volkswagen reduced tariffs on imported components (Kline, p. 66). Pennsylvania believed the plant would bring up to 15,000 jobs (including 5,000 at the plant) to the area and "over $80 million in additional state revenues over five years" (Ibid). A Northeast-Midwest Institute study in 1978 estimated the package to be worth 20 percent of the total cost of the project, and concluded that it amounted to a subsidy of $4,103 per job (Ibid). At the time, the VW incentive package was one of the largest ever offered in the U.S., and it raised considerable concern over the cost-benefit effectiveness of these kinds of recruiting techniques.

With a firm belief that additional U.S. production would help recapture market share, a second 200,000 unit assembly plant was announced for Detroit in 1980, and plans for an engine factory were publicized (Hood and Young, p. 175). However, sales collapsed in 1981, and 1982 sales were only about half the 336,000 units sold in 1980 (Ibid). In 1983, the Detroit plant, which had never gone into production, was sold to Chrysler. Production at the Pennsylvania plant peaked in 1980 at 177,106 units, but by 1984 had fallen to 73,838 cars (Bass, 1985, p. 19).

In 1987, the Pennsylvania assembly plant is still in operation, with production of the Golf--an upscale-Rabbit replacement--and an even more upscale Jetta model. However, according to Noel Phillips, president of the U.S. subsidiary, production at the plant is relatively uneconomic (Ward's Auto World, December 1986, p. 87). The plant is

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being run at reduced capacity, with a second shift closed down, largely as an insurance policy against further deutschmark shifts and increased protectionism. VW's U.S. market share has dropped further since 1976 to about 2 percent in 1987 (Ibid). The Charleston, West Virginia, stamping plant is being shut down this year (Ibid).

While VW Rabbits were initially produced at the Pennsylvania plant with 25 percent domestic content, by late 1979, the figure was reported to have risen to about 75 percent (Sinclair, p. 74). Any increases in domestic content were at least partly attributable to the further slippage of the dollar against the deutschmark. One company official admitted in congressional testimony in 1980 that domestic content was only up to about 60 percent (Hearing, March 19, 1980, p. 41). Claiming that domestic fuel economy requirements would discourage the attainment of anything greater than 75 percent domestic content, the company official said that Volkswagen wanted to buy more U.S. components (Ibid). In reality, key components such as engines and drive trains have always been outsourced. And, domestic content is likely reduced from 1979, with key components being imported from Germany, Brazil, and Mexico (Altshuler, et al., p. 169). Stampings, which have been produced in the U.S., are being sourced out to Mexico this year (Ward's Auto World, op. cit.).

Volkswagen's foreign trade subzone has been an important conduit for imported parts. In 1981, about $1,500 worth of parts from Germany were imported for each U.S.-produced VW sold in the U.S. (U.S. Dept. of Commerce, March 1985, pp. 30-31 and Bass, 1985, p. 19). The foreign trade zone status allows Volkswagen to import auto parts, without paying the three to six percent tariff generally placed on them.

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Instead, Volkswagen pays a lower duty of 2.7 percent (the rate applicable to assembled vehicles) on the value of the imported parts in the assembled cars when they leave the zone (U.S. Dept. of Commerce, op. cit.).

Largely, VW's location strategy failed to stem loss of market share. Probably the central reason is that it did nothing to stem the main competitive advantage offered by the Japanese producers--product differentiation. Also, U.S. producers quickly copied the VW product with the Ford Fiesta and Chrysler Omni/Horizon. While the Rabbit had been planned to help retain VW market share by updating the dated Beetle, it did not represent a shift away from Volkswagen's previous emphasis of high volume, standardized production, and limited product mix. Furthermore, Volkswagen found it could not match Japanese producers on cost, and VW has been plagued by continued suspicion of quality problems in its U.S. product (Hood and Young, p. 176).

4.5 Renault's Dalliance with American Motors Corporation

The Renault-AMC link-up is an example of an acquisition strategy for market entry, although in this case, it was clearly a flop. Renault, the French government-owned automakers had U.S. sales of up to 100,000 units per year during the 1950s, but the company suffered from weak after-sales service and a poor dealership network (Hood and Young, p. 176). Sales plummeted to an average of 5,000 to 10,000 units a year for most of the 1970s (Ibid). In 1979, Renault had 300 dealers in the U.S. and was importing about 15,000 LeCars (the Renault R5) a year, an obviously limited single product strategy (Ibid, p. 177).

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In contrast, in 1979, AMC had serious cash flow problems, only 1.7 percent of the U.S. market, and had suffered from limited new product development throughout the 1970s (Ibid). However, it had a largely intact 2,000 dealer distribution network, which Renault sorely needed in order to gain U.S. market share. At first, the two companies signed a sales and distribution agreement in 1979. AMC's increasing financial problems necessitated a 4.7 percent stock purchase and a $150 million transfer from Renault for conversion of an AMC plant for assembly of Renault's Alliance (R9) model. In 1980, continued financial deterioration required further Renault intervention with a $220 million stock purchase agreement that raised Renault's stake in AMC to 46 percent (Ibid). Renault also obtained the right to appoint 5 of AMCs 13 directors, including its managing director--thus virtual control over the company (Guiles, p. 2 and Savary, 1984, p. 182). Renault invested another $50 million in 1983 to begin production of an Americanized version of the Renault R11. By mid-1983, Renault had spent over $400 million on AMC. AMC did not return to profitability until 1984, and then by only the slimmest of margins (Bass, 1985, p. 14). The following year, American Motors was generating red ink again. Renault, which had needed a dealer network more than U.S. production, ended up with both and found itself faced with high costs (Altshuler, et. al., p. 141).

Over the short run, Renault's strategy generated considerable success in terms of sales volume. In 1983, the AMC Alliance garnered 1.5 percent of the U.S. market. This success was tempered by the fact that the car could have been supplied more cheaply, fully assembled from France, owing to the rise in the value of the dollar (Hood and Young, p. 178). As a distributor for French-made vehicles, the AMC

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tie-up was of limited usefulness. While import sales climbed steadily to 37,540 units in 1982, they had fallen off to only 12,243 in 1984, worse than before the acquisition (Bass, p. 19). As a result of the tie-up, AMC spun off all of its passenger car developmental work to Renault in order to concentrate on improvements to its Jeep-line, the only profitable division of the company (Ward's Auto World, December 1986, p. 84). Also, the company no longer has the product line or manufacturing expertise to survive by itself in the U.S. marketplace.

The production arrangement between American Motors and Renault has resulted in substantial imports of parts and components. The domestically produced Renault only has a domestic content of about 70 percent (Hood and Young, p. 178). Furthermore, AMC imports about 35 percent of all of its auto components (Flaherty, 1985, p. 4).

Renault's intervention did little to alter production and industrial relation strategies at American Motors. Of its three assembly plants in the U.S., its Kenosha, Wisconsin, and Toledo, Ohio, plants are among the oldest and least efficient assembly plants in the country (Guiles and Levin, 1987, p. 2). AMC's Toledo plant dates back to at least 1909 and has been described as a Rube Goldberg arrangement, with an assembly line snaking through a maze of 64 interconnected buildings (Merwin, 1986, p. 101). UAW locals in both Toledo and Kenosha "have used the threat of strikes to obtain the most lucrative contracts in the industry, including more generous paid vacations and a larger number of company-paid union officials" (Guiles and Levin, p. 2). In recent months, the Kenosha local has refused demands for concessions without which AMC will have to close the plant (Ibid). At Toledo, AMC negotiations for work rule changes resulted in workers sabotaging

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and intermittently shutting down the assembly line, "costing more than $1 million in lost wages" (Merwin, p. 102).

Renault has in recent months been looking for a buyer and may have found one in Chrysler, which announced a proposed acquisition of AMC in March of this year (Guiles and Levin, op. cit.). Although the deal has not been finalized, the sale would relieve Renault of a costly production venture and provide access to a strengthened dealer network, something that is what Renault really wanted all along. This contrasts ironically with a description of Renault's interest in American Motors in 1984: "Renault now...has a massive and irreversible commitment in the USA, where it is taking big commercial, industrial and financial risks" (Savary, p. 182).

4.6 Honda Announces for U.S. Auto Assembly

Against a background of negotiations to limit Japanese exports to the U.S., Honda announced in January 1980 its intention to invest $200 million in an Ohio auto assembly plant (Calton and Krumme, p. 200). Honda demonstrated greater willingness than any Japanese producer to commit to U.S. production, when faced with imminent trade restraints. The company had everything to gain from such a move and much to lose without it. After all, 50 percent of its production was destined for the U.S. and its share of the Japanese market was much lower than Toyota's and Nissan's, leaving it without strong domestic sales to fall back on in the event of further protectionist moves (Ibid). Also, labor resistance to locating production abroad was lower because its Japan plants were all operating at capacity in 1980. Prior experience with motorcycle production at the same site was also

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important in fomenting what was regarded as considerable risk-taking on the part of Honda. At the same time, Ohio had promised incentives which included "a $2.5 million grant to develop the site; a $90 thousand annual reduction in property taxes; designation of the site as a foreign-trade subzone with reduced import duties; a guarantee that the federal government would make railroad improvements valued at $300 thousand; and free English tutoring for Japanese expatriates and their children at a nearby state university" (Encarnation, 1986, p. 133).

Designed to produce 10,000 autos a month, the Marysville, Ohio plant began limited production in 1982, which it maintained through 1983, in an effort to achieve quality levels comparable to its Japan production (Hood and Young, p. 183). By 1984, its output was already in excess of original plans, at 133,601 units (Bass, p. 19). Honda's expansion of U.S. production has been rapid. Honda announced further plans for an assembly plant in Canada in April 1984 (Japan Economic Journal, May 1, 1984, p. 12). By 1985, Honda had finished doubling its Marysville plant size and passed American Motors to become the fourth largest producer in the U.S. (Ward's Auto World, January 1987, p. 27). The Marysville plant is scheduled to produce 370,000 Honda Accords and Civics in 1987 (Phelan, 1986, p. 82). With the Canadian plant coming on-line in late 1986, Honda expects to have North American production capacity for about 400,000 autos in 1989 (Ward's Auto World, December 1986, p. 90).

Honda set an initial target of 50 percent domestic content for its Marysville production (Hood and Young, p. 183). Indeed, by 1985, Honda was the first Japanese-owned producer in the U.S. to claim that the target had been met (Encarnation, 1986, p. 128) Honda has been

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aided in reaching domestic content targets because "its Japanese-based suppliers of headlights, auto fuel tanks, exhaust pipes, steering wheels, and auto engine parts also established plants within" Ohio (Encarnation, 1986, p. 132).

Perhaps more so than any subsequent Japanese producer, Honda has also made considerable efforts to transfer major component production to the U.S. Just last year, Honda began production of Civic engines at its Anna, Ohio motorcycle engine plant. The engines' domestic content is reported to be about 25 percent, "including diecasting, painting, machining and assembly" with critical components to be imported, but Honda claims to be aiming for 50 percent local content in engine production (Phelan, op. cit.). A few months later, Honda officials were claiming 50 percent domestic content for engines at the Anna plant (Stoddard, 1987, p. 85). At the same time, early in 1987, Honda announced that it would be the first Japanese producer to build in the U.S. "all the engines and other powertrain components for" its U.S.-assembled cars (Ibid). Part of the reason for Honda's increasing domestic content is attributable to change in the Dollar/Yen exchange rate (Ibid). This is also cited as a reason why, just a few weeks ago, Honda announced that it would start shipping a couple thousand of its cars produced in Ohio to Taiwan (Behr, 1987, p. H1). No doubt, politics and U.S.-Japan trade tension have also played a role.

Candace Howes, a researcher for the UAW, estimates that the domestic content of U.S.-produced Hondas is currently about 30-40 percent (Telephone Interview with Candace Howes, April 22, 1987). Allen Mendelowitz, a Senior Associate Director at the U.S. General Accounting Office's National Security and International Affairs Division,

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says that Honda's domestic content is about 50-55 percent (Interview with Mendelowitz, May 1, 1987). But Honda says it expects to boost its North American content to reach 66 percent by 1990 (Ward's Auto World, December 1986, p. 89). In keeping with this goal, Honda recently announced that affiliated Japanese parts manufacturers were also planning to set up operations in the U.S. in the near future. A Honda spokesman said that the parts makers planned to enter into joint ventures with U.S. firms in order to further raise the local content of cars produced by Honda in the U.S. and to "ease trade frictions with the U.S. parts companies" (Cullison, 1986).

By all accounts, Honda has made good progress in duplicating its Japanese production and labor relations systems in the U.S. Honda's Marysville plant is highly automated; from the time welding begins until the car is driven off the production line, "no human moves the car--it is done entirely by" machine (Merwin, 1986, p. 103). Honda's presses can change stamping dies in less than 10 minutes (Ibid). Honda also employs just-in-time inventory control, a process pioneered by Toyota in the 1960s. Honda's parts inventory is largely stored by suppliers, who deliver parts to the back dock only hours before they are required on the production line (Ibid). And, automation is constantly increasing, allowing for additional gains in productivity and production capacity. Another example of the flexibility of the production process at Marysville is that Honda was able to convert from production of 1985 Accords to 1986 models as the last 1985 cars were coming off the line--even though the two cars shared no major body parts in common (Behr, p. H2). In terms of productivity, each working day, Honda uses about 2,400 workers to produce 875 cars at Marysville; by contrast, American Motors needs more than twice the workers to produce 750 Jeeps per day at its Toledo, Ohio plant (Merwin, p. 102).

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While early production runs at Honda were intended to resolve any quality problems with American production, Honda officials concede that their U.S. workers are still learning. In Japan, Honda builds 70 to 80 percent of its cars without any defect repair. At Marysville, only about 40 percent of the units produced have met that standard (Behr, p. H2). But Honda's unrelenting obsession with consumer satisfaction keeps defects from leaving the plant. And, reviews in "the motoring press have found the quality of American-made Honda Accords to be equal, if not superior, to the Japanese-made product" (Calton and Krumme, p. 202).

Honda also stresses egalitarianism and communication in its workforce. There are no executive lunch rooms or private offices, and all employees, up to Shoichiro Irimajiri, president of its American manufacturing division, "wear white coveralls with their names stitched in red lettering above the right breast pocket" (Koepp, 1986, p. 49). In addition, workers "are divided into only two job classifications--assembly and maintenance--compared with as many as 100 in some unionized U.S. factories" (Ibid). This allows workers to perform a number of different functions, increasing their flexibility and usefulness in the production process. Production workers also "review management's disciplinary actions." If a worker is fired, he has a right to review by a randomly selected "peer panel," whose secret ballot can override the company's decision (Behr, p. H2).

Although Honda's hourly wages are lower than those specified in UAW contracts, they are only about one dollar an hour below the UAW average (Koepp, p. 49). Honda workers also do not have the benefits packages accorded to UAW workers. However, average hourly

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wages were $12.40 last year, with "an $832 annual bonus for good attendance and a $2,688 bonus check as a share of the company's worldwide income" (Behr, p. H2). With 9 and 10-hour days, the average Honda production worker received an income of $29,312 last year (Ibid).

Honda has made strident efforts to avoid a UAW presence in its plants. The rural Ohio location was a part of this strategy (Perl, 1985, p. A1). An early dispute centered on an employee's right to wear a UAW cap. Banned by Honda in 1981, this led to the filing of a complaint with the National Labor Relations Board (NLRB), "alleging that the cap was an attempt to prohibit a union" from being organized (Hood and Young, p. 183). The NLRB overturned the ban. Now, some workers wear the union logo, and one anti-union group of workers wears caps with a red slash through the logo (Perl, op. cit.). Some pro-union workers are concerned about seniority rights, feeling that promotions are more often based on favoritism. Honda Vice President Alan Kinzer claims that they are based on skill and employee commitment, with seniority only being a deciding factor in the event that employees are equally qualified (Ibid). Significantly, more than 30 percent of Honda's Marysville employees have petitioned for UAW representation, but the UAW has not been successful in organizing the plant (Perl, p. A1 and Behr, p. H2).

Honda's investment strategy for U.S. production has paid off nicely. By 1984, Honda was able to enlarge it's U.S. market by 36 percent above its quota under the voluntary export restraint agreement. Within a couple of years, half of the Hondas sold in the North American market will be produced in North America.

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4.7 Nissan Experiments With Light Truck Production

Nissan was considerably more reluctant than Honda to commit to U.S. production. As one of the "Big Two" Japanese producers (Toyota being the other one), Nissan had considerable domestic Japanese market share to insulate it from sudden protectionist moves on the part of the U.S. Only about half of its exports went to the U.S. market in 1979, or about a quarter of its total output (Calton and Krumme, p. 201). Also, Nissan preferred the greater flexibility and economies of scale possible with centralized export production. Besides, Nissan had already made a decision in 1980 to expand production capacity in Japan (Ibid). In congressional testimony in March 1980, Suzuki Yasuhiko, Nissan's vice president for external relations, protested that there was no basis for locating production in the U.S.: "We are constantly advised to decide promptly to establish an assembly plant in this country....[but] at the present time there is little economic justification for Nissan to contemplate the three to four hundred million dollar investment required to establish a production plant in the U.S." (Hearing, March 19, 1980, p. 82). Nonetheless, protectionist overtures by the United States were strong. In April 1980, Nissan announced that it would invest $300 million in the U.S. for a light truck assembly plant (Ibid).

Another factor possibly influencing Nissan's decision was the increasing relocation of Japanese parts manufacturers to the U.S. (Hood and Young, p. 184). In congressional hearings, Nissan's representative had complained about the difficulty of sourcing adequate components in the U.S. (Hearing, March 19, 1980, p. 82). Already a dozen Japanese auto component manufacturers had set up production in the U.S. by 1980, and by 1983, such production accounted for 4-5 percent of the U.S. parts market (Hood and Young, op. cit.).

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Nissan reportedly decided to build a pickup truck assembly plant because of quality concerns regarding American workers and their ability to assemble autos (Halberstam, p. 621). Nissan's president, Takashi Ishihara, commented that "we are unsure about the American workers and we are concerned about quality--and if the vehicles are not going to be up to quality, then at least we want them to be our lowest-selling item" (Ibid). This may have been exaggeration. The investment must also certainly have been in anticipation of a May 1980 U.S. Customs decision which disallowed a 4 percent duty on light trucks imported "incomplete"--with the truck and bed separately assembled in California--in order to avoid a much higher 25 percent duty on "completed" light trucks (Hood and Young, pp. 183-184 and Calton and Krumme, pp. 201-202).

Another consideration must have been that Nissan's product line-up in the U.S. was considerably more differentiated than Honda's. In 1980, Honda sold two basic models--the Civic and Accord; production of either in the U.S. offered considerable potential for scale economies. Nissan, on the other hand, offered a full-line of small, medium-sized, and sport vehicles, including light trucks. Because of the numbers of units sold of each type of car, the size of the U.S. market for a single truck model (over 100,000 imported in 1979), as well as the fewer components involved in truck manufacture, scale economies would have been easier to achieve with production of light trucks (Calton and Krumme, p. 201). In any case, the decision for a truck assembly plant was hardly a token one as it eventually amounted to a $660 million project and represented one of the largest overseas investments ever undertaken by a Japanese company (Hood and Young, p. 184).

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The Smyrna, Tennessee site selection was announced in November 1980 (op. cit., p. 183). Smyrna was a rural area, selected by Nissan for it's good rail connections (through proximity to Nashville), Tennessee's right-to-work laws, and because it was believed to be far enough away from areas of potential UAW organizing (Halberstam, p. 620). Competition for the truck plant had been extensive. Expected to produce 2,000 jobs and a payroll of $40 million, Nissan had drawn offers from 39 states (Kline, p. 67). Illinois' Governor Jim Thompson had flown to Tokyo twice to woo Nissan's assembly plant (Halberstam, p. 620). Ohio's Governor Jim Rhodes had personally met Nissan's representatives at the airport in Columbus, and flew them around the state in his personal plane (Ibid). Tennessee had offered an incentive package worth over $66 million, including federal, state, and local funds to pay for "road, water, sewer, and rail links" to Nissan's facility. Tennessee's package also included $1 million in reduced property taxes and $7 million in state-subsidized training for workers (Encarnation, p. 133). Tennessee officials estimated that the $37 million committed by state and local governments would be paid back within five years through increased tax revenues (Kline, p. 67).

Truck assembly operations began in June 1983 and within a year, the plant had built up enough capacity to produce 10,000 trucks a month (Halberstam, p. 622). Anticipating enactment of domestic content legislation and encouraged by the success of the truck assembly operations, in 1984, Nissan announced plans to assemble cars at the plant (Ibid, and Gordon and Lees, 1986, p. 179). The same year, one of its associated suppliers (virtual subsidiaries), Nihon Radiator, established an air conditioning and heating plant close to the Smyrna operation (Hood and Young, p. 184 and Winter, 1986, p. 105). The

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first Nissan Sentras rolled down the assembly line in March 1985. By the end of the year, with 3,000 employees working two shifts, Nissan had assembled 240,000 cars and trucks (Halberstam, p. 622). Still, most of the assembly work is dedicated to truck manufacturing. Nissan only produced 65,690 Sentras at its Smyrna plant in 1986 (Wall Street Journal, March 9, 1987, p. 1). Plans for 1987 are to produce about 60,000 cars (Ward's Auto World, December 1986, p. 94).

Nissan Motor Mfg. Corp. has taken great pains to paint itself a U.S.-based company, including hiring a Ford executive, Marvin T. Runyon, as president, to run the operations at Smyrna. Runyon takes every opportunity to tell the press that "his enterprise is an American company that pays American-size wages and pays American costs" (Winter, 1986, p. 103). Nissan's likeness to an American firm stops, however, when it comes to foreign sourcing. Recently, Runyon admitted that the Japanese content of the vehicles produced at Smyrna was 50 percent, with about 10 percent of the dollar value of parts coming from Mexico, and only 30 percent from the U.S. (Ward's Auto World, December 1986, p. 94). Nissan officials in Japan, however claim that the domestic content of the vehicles produced in the U.S. are already 50 percent, up from 38 percent in 1983 (Journal of Commerce, July 28, 1986). Robert Frinier, Nissan U.S.A.'s vice president for material and systems, said recently that there are certain constraints on domestic sourcing. "You need an output between 300,000 to 500,000 to make investing in engine and transmission plants here cost efficient," he said (Ibid). And, currently, Nissan has no plans to boost output beyond the 240,000 cars and trucks per year now assembled at its Smyrna plant. Runyon says that Nissan is trying to meet a goal of 60 percent domestic content by 1990 (Ward's Auto World, December 1986, p. 93).

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Like Honda, Nissan's operation is highly automated. Similar management and industrial relations practices are also in effect. Smyrna has only five layers of management in contrast to the 12 at Ford (Halberstam, p. 622). Status distinctions have been reduced. Managers, including Runyon, also work on the shop floor and dress in the blue fatigues worn by other workers. Workers can be reassigned to various tasks within the plant without onerous union work rules intervening. Greater job security has been promised for increased commitment to quality, reduced absenteeism, and worker flexibility as concerns assignments and training for new ones (Calton and Krumme, p. 203). And pay is similar to UAW wages, up to $29,000 a year with overtime (Halberstam, p. 622).

Nissan has gone to great lengths to keep the UAW out of its Smyrna plant, including reportedly administering psychological screening tests to weed out potential workers who would consider joining unions (Ibid). This is something which Runyon denies (Ward's Auto World, December 1986, p. 94). To date, the UAW has not enjoyed any success in attempts to organize the plant.

Strategically, as Honda has, Nissan has enlarged its U.S. market share beyond the level allowed under the voluntary export restraints enforced by MITI by means of production in the U.S. At the same time, the commitment to U.S. production has ensured a steady stream of high-value added components from Japan and reduced U.S. protectionist pressures, as well.

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4.8 Toyota's Cautious Entry--A Joint Venture With GM

In spite of the fact that the Japanese government had announced in 1980 that Toyota was considering a U.S. investment, Toyota's president, Eiji Toyoda, flatly ruled out such a possibility in late 1981 (Jiji Press, May 15, 1980 and Japan Economic Journal, December 29, 1981, p. 7). At about the same time, rumors about a possible linkage between Ford and Toyota for U.S. assembly were being bandied about. Industry analysts have speculated that Toyota's intent in discussing production with Ford was simply a game of playing for time against the hope that protectionist sentiments in the U.S. would fade (Calton and Krumme, p. 203). At any rate, any talks with Ford must have ended inconclusively, because a new round of talks between Toyota and General Motors commenced in March 1982 and resulted in a February 15, 1983 announcement to co-produce a Toyota-designed car in an idled GM plant in Fremont, California (Ibid). Even in pursuing talks with GM, both automakers were aware of the wary eye that the U.S. government would probably cast toward an agreement between the world's number one and number two auto producers. Toyota must have suspected that the joint venture would run into problems in this respect, signifying that this may have been another tactic for delaying entry into production in the U.S.

Even more so than Nissan, Toyota was reluctant to enter into U.S. production. Like Nissan, it had also made a major investment in additional production capacity in Japan in 1980, and only about a quarter of its output was destined for the U.S. (Ibid, p. 201). Also, its suppliers were highly centralized in Japan, making "just in time" production abroad problematic. And, its product line-up was highly

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differentiated with few opportunities for the achievement of scale economies. Toyota delayed longer than any other major Japanese automaker in entering into U.S. production.

This reluctance is also demonstrated by Toyota's entry strategy. Rather than taking large financial risks or endangering its reputation for quality, Toyota assumed only half of the cost and produced all of the cars under GM nameplate (at least, until this past fall) (Bush, 1986, p. 99 and Altshuler, et. al., p. 188). Furthermore, for Toyota, the risk of competitively enhancing GM at its own expense was reduced because the car was an older design (Toyota Corolla), containing no new engineering or design technologies (Hood and Young, p. 180 and Altshuler, et. al., p. 188 and Holusha, 1987, p. 31). Also, for Toyota, the risk of transferring too much production knowledge to GM was reduced because Toyota did not introduce large-scale automation at the plant, which made the plant an experiment, more than anything else, in human production systems--how to utilize workers effectively (Rettie, 1986, p. 96).

As part of the GM-Toyota joint venture agreement, GM supplied a former GM assembly plant and about $20 million, while Toyota supplied $150 million for plant redesign; the total estimated cost of the venture was $300 million (Hood and Young, p. 179 and Calton and Krumme, p. 203). Toyota supplied "the [car] design, much of the high-value-added componentry [including engines and transaxles], the design and layout of the plant, the machine tools, and the management and management systems. GM would supply the facility and a set of managers to work with the Japanese, and would purchase the output of the plant and market the cars as Chevrolets" (Dyer, et. al., p. 221).

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Significantly, the workers would be represented by the UAW and drawn mostly from the pool of laid-off workers formerly employed at the plant, although early on, Toyota fought both. Ironically, the plant had been closed in 1982 "because of the success of Japanese imports and a history of nasty management-labor relations at the facility" (Ibid, p. 242 and p. 154).

The joint venture was named "New United Motors Manufacturing, Inc." (NUMMI), a jointly owned company to be controlled by an equal number of GM and Toyota directors and a president, or chief executive officer, to be designated by Toyota (Hearing, February 8, 1984, p. 479). Almost immediately, the proposed link-up between the world's two largest car manufacturers was challenged. Chrysler filed a lawsuit, trying to get the government to take antitrust action against the joint venture (Dyer, et. al., p. 177). American Motors and Ford also protested the link-up, claiming that the venture would have anti-competitive effects and enhance GM's position in the automobile market (Hearing, February 8, 1984, pp. 346-360 and pp. 363-381). The Federal Trade Commission (FTC) also initiated a review of the joint venture, the upshot of which was that the FTC decided how the venture would be run as a condition of its approval (Dyer, et. al., pp. 221-222):

> ...the government...decided how many cars the joint venture would produce (a maximum of 240,000 per year, with no option for a second assembly line, regardless of demand for the product); how the price for the product should be set (based on a government-specified formula applied to a weighted average of a number of comparable small cars); how long the joint venture could last (twelve years and no longer); and how the two sides of the joint venture could communicate (a "Chinese Wall" was to be built between GM and Toyota and a complete file on all communications kept for annual government review).

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In addition, the FTC also prohibited the two companies from sharing product development and engineering activities (Hearing, February 8, 1984, p. 495). The Commission's decision was handed down on April 11, 1984 (Ibid, p. 494).

In spite of the Commission's ruling, Toyota and GM saw the joint venture as an important experiment. Toyota viewed it as an opportunity to learn about U.S. workers and suppliers, without having to build a new facility or risking a major commitment. General Motors hoped to learn about Japanese-style management and see whether it could work with UAW-organized workers, as well as gain a new subcompact to fill out its model offerings.

Currently, Toyota has placed about 30 managers with NUMMI, and GM has placed 16 (Rettie, 1986, p. 96). Plans are to rotate each back to their parent companies after 2-3 years, and rotations have already started in some cases. Another 20 managers are strictly NUMMI employees; their numbers are expected to grow as NUMMI attempts to build an internal management structure (Ibid).

NUMMI got off to a slow start with auto production beginning in 1985. By 1986, it was producing about 200,000 units a year with 2,500 workers, mostly Chevrolet Novas (a Toyota Corolla-derivative) and a smaller numbers of Toyota FX-16's (a sporty subcompact) for distribution by Toyota dealers (Ibid and Bush, 1986, p. 99). The FX-16's only joined the Novas on the assembly line just this past September (Bush, p. 99). This year's target is to produce 180,000 Novas and about 50,000 FX-16's, although GM is now starting to have some trouble in selling the Novas--they believe that this is because of

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the quality problems consumers associate with the GM nameplate (Holusha, 1987, p. 31 and Wall Street Journal, March 9, 1987, p. 1). Toyota is not reporting difficulties selling the FX-16's.

Robert Schultz, head of GM's Chevrolet-Pontiac-Canada Group, reports that local content in the Novas is only 40 percent at the present, although GM is hoping to improve it over time (Ward's Engine Update, March 16, 1987, p. 7). Toyota claims a domestic content of about 50 percent on the FX-16's (Bush, p. 99). However, according to a trade specialist with the U.S. General Accounting Office, the domestic content in any of of the cars produced at NUMMI is at most 40 percent. While major body panels for the Novas are produced in the plant, on NUMMI's stamping equipment, the FX-16's are basically knock-down kits assembled from parts made in Japan (Interview with Mendelowitz, May 1, 1987).

From the very beginning, the NUMMI plant has been an experiment in labor relations, with important implications for the future of labor agreements in the auto industry as well as the role of the UAW in the industry. In fact, the UAW-NUMMI agreement served as a model for the agreement signed with the UAW for GM's new Saturn division. Early on, there had been disagreement over whether the UAW would represent NUMMI workers, but once Toyota accepted the idea and NUMMI entered into negotiations with the UAW, both sides were able to come to an agreement. Some of the provisions in the three year contract were the following (Monthly Labor Review, September 1985, p. 51):

- A commitment to take affirmative measures such as reducing

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salaries of officers and management employees and returning work to the bargaining unit before laying off any UAW-represented employees.

- Joint committees to resolve problems resulting from employees not being able to perform operations within allotted time-frames.
- "A joint committee to implement a comprehensive health and safety program."
- Joint management-labor consideration of cases involving the possible suspension or firing of workers.
- A commitment that seniority should be the deciding "factor in transfers and reassignments," all other factors being equal.
- "A total of 45 paid holidays over the term" of the contract.
- "...automatic quarterly cost-of-living adjustments matching that at the other companies..."

The contract also resulted in base pay-rates of $13.28 an hour for assemblers and $15.95 an hour "for top-rated skilled workers," rates that were slightly higher than in existing Ford and GM contracts (Ibid).

Perhaps the most astounding aspect of the contract is the commitment to reduce the salaries of executives and bring outsourced work back in-house before laying off workers. This is particularly so when considering that the top executives of U.S.-based auto companies often receive large bonuses, even as they outsource more and more production and lay off thousands of employees. But more important than the contract itself is that a Japanese-affiliated automaker has been able to sit down at the negotiating table with the UAW and work out a mutually agreeable contract.

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Contract or not, NUMMI has spared no effort in attempting to introduce U.S. workers to Japanese-style industrial relations. Several hundred NUMMI workers were sent to Japan to observe and be trained in the Toyota's production system, including "cooperative approaches to problem solving, dealing with subordinates and simply getting along with each other under the pressure of high speed auto production" (Holusha, 1986, p. 19). At the Fremont plant, workers are deployed in groups, each having a particular "area of responsibility rather than placed individually along the line as has been the American practice" (Ibid). As at Nissan and Honda, status distinctions have been reduced. Everybody, management and workers, wears the same uniform, eats in the same cafeteria, and receives the same parking privelidges (Ward's Auto World, April 1987, p. 30). Open communication and problem solving are encouraged, along with a spirit of cooperation (Ibid).

For Toyota, NUMMI has been a great success. First, it has helped defuse increasing protectionist sentiments at half the cost and with less risked than either Nissan or Honda (Calton and Krumme, p. 203). Beyond that, it has also provided Toyota with the knowledge that it can work with U.S. labor, and at least to a certain extent, U.S. suppliers. This has been important in its decision to build another wholly-owned assembly plant in Georgetown, Kentucky. The Georgetown plant will start producing 200,000 subcompacts in 1988 (Ward's Auto World, January 1987 p. 26). One unknown is whether Toyota will yield to UAW representation at the new plant. Given Toyota's feeling of success with unionized workers at NUMMI, this should not be a problem. One sign of potential trouble is the recent controversy over hiring of unionized construction workers at the Kentucky site. Toyota signed an agreement for hiring union workers

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with 16 building trades unions last November to settle the controversy, but only after a series of lawsuits, demonstrations in front of the Japanese embassy in Washington, and other threatened protests (Noble, 1986, p.11 and Molotsky and Weaver, 1986, p. 10). In addition to the Kentucky plant, Toyota is also readying a 50,000 unit plant in Ontario, Canada for production beginning in 1988 (Winter, 1986, p. 102).

4.9 Other Automobile Investments

With some form of voluntary export restraints still in force, smaller Japanese automakers have found that the only way to significantly expand exports and increase market share is to locate production facilities in the U.S. or Canada.[35] In some cases, these investments will more than double the capacities of these manufacturers to service the U.S. market. Among these automakers are Mazda, Mitsubishi, Fuji Heavy Industries (Subaru) and Isuzu, Daihatsu, and Suzuki. In addition, South Korea's Hyundai is building a plant in Canada (Winter, 1986, p. 102).

U.S. automakers are also involved in some of these ventures. Mitsubishi's 240,000 unit plant in Bloomington/Normal, Illinois, will be co-owned with Chrysler, with each partner taking a portion of the output. It is set to begin production in 1988 (Ibid). Half of the output of Mazda's 240,000 unit plant in Flat Rock, Michigan is slated for Ford dealerships. Production should begin in 1988 (Ibid and Dyer,

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[35]Recall that because of a 1965 agreement on auto production and trade between the U.S. and Canada, the two countries represent virtually an open market for auto production traded between the two countries.

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et. al., p. 300). Suzuki and GM have entered into a joint venture to produce 200,000 utility vehicles and minicars in Ontario, Canada beginning in 1988 (Winter, p. 102).

In one case, two Japanese manufacturers are cooperating in a single venture. Fuji Heavy Industries and Isuzu have decided to open a plant in Indiana that will produce 240,000 subcompacts and utility vehicles beginning in 1989 (Pastor, 1986, p. 1).

4.10 Implications for Management, Industrial Relations, and New Technology

As we have seen in the case of Volkswagen and Renault, foreign-ownership of auto production, by itself, does not necessarily signify better management, improved industrial relations, or new technology. By all accounts, however, the Japanese-owned assembly plants offer instructive lessons for U.S. managers. While Honda and Nissan may offer good examples of the skillful use of technology in production systems, Toyota has demonstrated that a well managed production system need not be highly automated to yield significantly improved productivity and output. In any case, all of the Japanese-owned plants have demonstrated the importance of well thought out, flexible production systems for achieving optimum results. Significantly, labor is important in this strategy, also.

All too often, U.S. production systems use workers as though they are appendages to the production line, performing routine, standard tasks. Workers are not engaged to align themselves with management, or the company, or the people employed in the firm. Incentives for

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performance improvement, whether the worker's or the production line's, are rare or nonexistent. Opportunities for exercising initiative, or to be rewarded for doing so are limited or nonexistent. When the factory is idled due to some production bottleneck, so too are the workers, or they are laid off. Relations between labor and management are too often adversarial, with each striving to improve his temporary advantage at the expense of the other party, and to the detriment of the competitiveness of the manufacturing firm.

In contrast, Japanese production systems tend to use workers as though they are important to the firm's strategic balance in marketplace. Because managers know that long-run competitiveness is dependent on cooperation between management and labor, they have developed strategies for catering to workers' natural desires to feel needed, respected, and secure--things that are neither uniquely Japanese nor alien to American culture. Part of this approach is reflected in the organizing of production "teams" or quality circles in which workers share decision-making and production tasks. It is also reflected in the sharing of information among workers and management, which helps promote a more harmonious working environment. Partly, too, it is demonstrated in the elimination of artificial barriers to a harmonious workplace, such as plush executive suites, lunchrooms, and other management perquisites (even the traditional executive uniform of suit and tie) that only foster among workers a disgruntled sense of "us versus them." Importantly, it is also shown in the way in which job security is upheld, almost at any cost. Upholding job security is also made easier because workers are more often trained in a number of tasks, and able to shift flexibly from one assignment to another depending on production peaks and valleys.

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Can the Japanese approach to industrial relations be transplanted to the United States? There is no reason why it cannot, if managers and workers are able to set aside any adversarial distrust for long enough to negotiate. In fact, whether in a unionized or a non-unionized environment, the Japanese "transplant" automakers have demonstrated the ability to employ such strategies in the U.S. Unfortunately, many Japanese firms, including Honda and Nissan, have demonstrated poor public relations skills and poor strategic sense in their dealings with U.S. unions, especially the UAW. The Toyota-UAW agreement, however, argues well for the art of negotiation, employed so well in Japan. In this case, both Toyota and the UAW managed to walk away from the bargaining table with an agreement that captures the essence of what both wanted--in Toyota's case, a flexible workforce, and in the case of the UAW, a new local. The other Japanese carmakers would do well to bargain with organized labor, if only for additional long-run strategic security in the U.S. market. After all, the UAW has been the strongest proponent of automobile trade protectionism.

Will American firms make an effort to improve industrial relations, given the example set by the Japanese producers in the U.S.? General Motors has reportedly attempted to do so. The Toyota-UAW agreement was instrumental in their negotiations with the UAW over a labor contract for the new Saturn division. Beyond this, it is difficult to say how far such efforts may go. After all, the U.S. industrial relations system is a long-ingrained one and habits are difficult to break, especially where corporate America is concerned.

While most of the Japanese auto producers are employing state

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of the art technology and automation in their U.S. assembly plants, it is difficult to say what kind of spinoffs this may entail for U.S. producers. The manufacturing know-how embodied in the use of production machinery within each plant is proprietary. The GM-Toyota assembly plant, because it is a joint venture, should offer the opportunity for technology transfer, except that it is not a highly automated, technology-intensive operation--perhaps by Toyota's design. While the technology employed in foreign-owned auto plants may improve the competitiveness of foreign-based producers, it will probably not offer significant benefits to U.S.-based producers.

4.11 Implications for Jobs, Linkages, and Imports

Foreign-owned auto producers in the U.S., including Volkswagen, Honda, Nissan, and Toyota, are not as fully integrated into the economy as are the major U.S. producers (GM, Ford, and Chrysler). Recently, it was reported that the domestic content of U.S.-produced Chrysler vehicles was at least 90 percent (Flaherty, 1985, p. 3). Ford reported last year that its domestic content was 93 percent (Interview with Candace Howes). According to the UAW's Candace Howes, Chrysler's domestic content is the least of the "Big Three" U.S. producers, so General Motors must rate more favorably still (Ibid). This is changing, though, as U.S.-based producers look for ways to cut costs by shopping for more parts off-shore. However, the practice of foreign sourcing for auto components "is especially prevalent among U.S. auto plants with Japanese automaker participation. Japanese-owned auto assembly plants in the United States use a far higher percentage of components made outside the United States than do U.S.-based automakers in their U.S. plants" (Ibid).

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There can be no doubt that while the "transplant" carmakers may improve their domestic content on autos produced in the U.S. over time, especially with further currency reallignment, purchases of American componentry will remain low in comparison with major U.S. auto producers. U.S. auto parts manufacturers, who have anticipated greater sales owing to the relocation of Japanese production to the U.S, will be disappointed by this. But they will be further distressed by another growing trend--the increasing number of Japanese auto parts makers who are relocating to the U.S. From 1981 to 1985, at least 30 Japanese automotive components manufacturers located or began constructing plants in the U.S. (Japan Economic Institute, 1986). According to the Ann Arbor, Michigan-based Industrial Technology Institute, as many as 200 Japanese auto parts manufacturers will locate in the U.S. by 1990--and as much as 25 percent of their business will be with General Motors, Ford, and Chrysler (Winter, 1986, p. 103).

While Japanese parts manufacturers have apparently located in the U.S. to serve their major end-users, the Japanese-owned auto assembly plants, they are increasingly landing contracts with U.S. automakers. But Japanese auto parts makers have been accused of preferring "to make their products, and their profits, with Japanese labor in Japan" (Wysocki, 1986, p. 20). While Japanese auto parts makers have relocated certain aspects of their production to the U.S., Japanese exports of auto parts to the U.S. have skyrocketed--up 67 percent in 1984, and up another 30 percent to $2.48 billion in 1985 (Ibid). Just one example is Nippondenso Mfg. U.S.A. Inc., a Toyota-affiliated parts company located in Battle Creek, Michigan. Nippondenso currently imports about 64 percent of the parts and materials it uses (Winter, p. 105). The increased location of "transplant" auto suppliers

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in the U.S. is already generating friction because of import activity. Says UAW president, Owen Bieber, "A hypothetically 'pure' domestic assembly plant--one that sources the entire car from domestic suppliers--creates 11 back-up parts and supplier jobs for every assembly job....The typical transplant assembly operation creates only three." (Winter, p. 103). According to Konomi Tomisawa, an economist with the Long-Term Credit Bank of Japan, the nominal domestic content of Nissans and Hondas produced in the U.S. may be 50 percent, but coming up with this figure involves a bit of slick accounting. "Actually, these cars are 80 percent imported parts," she says, and the automakers do not dispute this (Wysocki, p. 20).

Whether it is parts, automotive engineering, or assembly work, less domestic content means fewer jobs, lowered multiplier effects, and diminished economic development potential. On top of this, U.S. manufacturing know-how also suffers. With global and domestic overcapacity becoming an issue in auto production, it is almost inevitable that older U.S. plants will be shut down--and recent G.M. announcements to this effect are a good example (Wall Street Journal, March 9, 1987, p. 1). This may not seem bad at first glance. Many economists applaud this kind of restructuring as a way to rid the economy of older, inefficient plants. At the same time, such plant closures surely reduce the level of linkages in the auto industry, even if the increasing production capacity of foreign automakers in the U.S. is taken into account. In essence, older plants that are currently supporting a substantial number of jobs in linked industries are being replaced by newer plants, providing little direct or indirect employment.

Not only do such trends presage lowered linkages and economic

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development potential of new plants, they also mean lost jobs throughout the industry. These are jobs that will not be replaced, in spite of the building of new auto production capacity in the U.S. by foreign auto makers. Between 1979 and 1985, employment in the motor vehicles and equipment industry (SIC 371) was off by 140,500, or 16 percent (Annual Survey of Manufactures, 1980 and 1985). Employment loss in the portion of the industry that performs automobile assembly (SIC 3711) accounts for slightly more than half the amount, at 73,600 jobs. Employment in affiliated parts industries was off by another 29,300, or 11 percent between 1979 and 1985 (Ibid). Between 1979 and 1985, these auto parts and components industries recorded employment loss: Engine Electrical Equipment (SIC 3694), -11,500 jobs; Automotive Stampings (SIC 3465), -6,100 jobs; Carburetors, Pistons, Rings, and Valves (SIC 3592), -4,600 jobs; Storage Batteries (SIC 3691), -4,100 jobs; and Vehicular Lighting Equipment (SIC 3647), -3,000 jobs.

Soaring production of "transplant" firms will further exacerbate employment loss. By 1988, it is expected that Japanese automakers in the U.S. will be assembling no less than one million cars annually, more than the total production Chrysler has scheduled for that year (Encarnation, 1986, p. 128). Within a few years, the figure could rise to more than two million units (Winter, p. 102). It is estimated that foreign-owned plants could create 35 percent excess capacity in the auto industry, displacing thousands of additional jobs--even if some of the employment is replaced at the new factories (Winter, p. 103). The employment loss experienced to date contrasts starkly with the new assembly plant jobs created by foreign-owned automakers, a figure which at best amounts to no more than 12,000 to 15,000 jobs currently (includes various estimates of Volkswagen, Honda, Nissan, and Toyota

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assembly plant employment). With new foreign-owned plants coming on line, the jobs created may double, but not much more than that. About the jobs that are being--and will be-created, Harvard-researcher Robert Reich comments (1983, p. 186):

> ...these facilities are, for the most part, assembly operations. Advanced components, made elsewhere, are merely put together by relatively unskilled America workers. They constitute the lowest-valued end of the production process, an area where American could retain long-term advantage only if wages fell drastically. Most of these are dead-end jobs, which count for very little in the emerging system of international trade. Those who perform them will be consigned to a relatively low standard of living, measured against the rest of the industrialized world.

Even with increased domestic components sourcing on the part of the foreign-owned producers, it is doubtful that the lost jobs in the automobile parts industries will be recovered. After all, the increased presence of foreign-owned parts makers favors increased imports of auto parts.

More importantly, the increased presence of foreign-owned automakers favors increased imports of fully assembled autos. Japanese automakers view these ventures as a way to increase market share while voluntary export restraints are in place. A big uncertainty is whether Japanese-owned production would be retained in the U.S. in the absence of such restraints and in the absence of protectionist sentiments. It is fairly certain, though, that in the absence of export restraints, imports would surely be stepped up.

The very existence of Japanese-owned production facilities in the

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U.S. makes for a powerful political device to be used against too onerous protectionist measures. In fact, it has already been alleged that foreign-owned auto assemblers pick their sites so as to maximize their political clout (Winter, p. 103). To date, each manufacturer has chosen a separate state in which to locate, and the suspicion is that this has been planned in order to gain as much political leverage with Congress as possible--in order to influence any future legislative debate over domestic content and import restrictions. The increased dependence of domestic producers on joint-ventures with foreign producers in the U.S. will also work against measures to protect the U.S. industry. By 1989, U.S. automakers will be sourcing as many as 500,000 or more units from such U.S.-based ventures (Dyer, et. al., 1987, pp. 291-301). The strategic dimension is hard to ignore. While foreign producers gain the upper hand in the U.S. market, domestic producers are being bought into political submission through temporary alliances that only help to maintain short-run market share.

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Chapter 5

Recent Federal Policy Towards FDIUS

5.1 Introduction

U.S. government policy towards inward-bound foreign direct investment has been described as largely an "open door" policy in the post-war period. In reality, the policy has vacillated between investment promotion and strict neutrality, with occasional recent calls for restrictions. An "open door" policy has made sense during a time when the U.S. was a net exporter of capital and the recipient of comparatively little direct investment from abroad. The magnitude of foreign direct investment in the United States has been changing dramatically, however. Since the early 1970's, when the most recent surge in FDIUS first began to be acknowledged, administrations have largely continued to emphasize the open door policy--either welcoming or turning a blind eye to increased investments, even as new concerns have been raised by the public and Congress.

The U.S. stance remains probably the most receptive of all developed nations. The few restrictions placed on FDIUS by the Federal government, almost all governing foreign ownership in what have been considered to by national security-sensitive sectors of the economy,

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largely predate the current period. More recent restrictions have been aimed at placing foreign and domestic-owned firms on the same competitive footing, especially in the banking sector and also with respect to taxation.

While FDIUS has played an important role in the economy, even in the last century, only recently has the Federal government taken an interest in ascertaining the magnitude and impact of foreign direct investment in the economy. One factor, in particular, led in the early 1970's to the first Federal attempts to systematically monitor FDIUS. This was the sudden rise in economic power through cartelization of the predominantly Middle Eastern oil-producing states. The result was higher U.S. prices for imported oil, a dramatic increase in the cash-liquidity of a few Middle Eastern nations, and a temporary embargo of Middle Eastern oil supplies as a result of U.S. support for Israel. The effect of the oil cartel provoked fears in the public's mind that a handful of oil-rich nations would use their new dollar surpluses to buy up U.S. assets, or in some other way endanger the U.S. economically--as they had done with the oil embargo, and resulted in Congressional calls for an assessment and review of foreign investment's impact on the economy. Increasing performance requirements for foreign investment in the developing world, calls in the U.N. for a codification of the creation of Canada's Foreign Investment Review Agency, in 1974, also brought out additional congressional demands for a U.S. investment monitoring and review process.

Legislation passed in the Ford and Carter administrations provided those administrations with the authority to collect information for evaluating the scope and impact of FDIUS--an information gathering

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effort which continues today. The Ford Administration also set up an interagency Committee on Foreign Investment in the U.S. to monitor investments and recommend policy. While each administration was essentially pledged to the "open door" policy, it was hoped that efforts to collect and assess information on foreign direct investment would, at least in the short run, satisfy calls for more harsh measures.

While paying lip service to the open door policy articulated by previous administrations, the Reagan Administration's policy towards FDIUS has entered into a state of flux hitherto unknown in the postwar era. While emphasizing "neutrality," especially early in the Administration, Reagan policy has undergone some subtle and not so subtle shifts, which distinguish it from the policy of preceding administrations. As government officials and the public have attempted to come to grips with the disturbing implications of U.S. policy in a changing world, so too have proliferated a multitude of responses, both official and unofficial, to increasing foreign investment in the U.S.

The following discussion will trace the development of U.S. policy toward FDIUS since the 1970's, when such policy was largely articulated for the first time. The development of the current institutional framework for monitoring and collecting information on foreign direct investment will also be discussed. The analysis will then focus on the changes in U.S. policy that have taken place with the inception of the Reagan Administration. As will be seen from the discussion, U.S. policy on foreign direct investment has had little to do with the economic development potential of foreign investment.

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5.2 Federal Policy in the Pre-Reagan Years

Before the First World War, the U.S. had been a net debtor nation in terms of international investment. Foreign investment in the U.S. was twice as large as U.S. investment abroad. Immediately following the war, in 1919, U.S. investment abroad was 3.9 times the level of foreign investment in the U.S. Of course, this includes portfolio investment as well as official government assets. In 1914, FDIUS had been about half the level of U.S. outward direct investment. But, just as the total investment position shifted dramatically during the war, so too did the direct investment position. Outward-bound U.S. investment expanded 1.5 times between 1914 and 1919, while FDIUS contracted by almost a third. Part of the contraction of FDIUS owed to the liquidation of European assets to pay for armaments (Lenrow, 1976, p. 113). The U.S. also confiscated substantial German and allied states' assets during the war, owing to the passage of the Trading With the Enemy Act in 1917 (Buckley and Roberts, 1982, p. 126; American Bar Association, 1979, p. 8).

Between the 1920's and the 1970's, a large period of *relative* unconcern over foreign direct investments in the U.S. has prevailed--except for a few of cases of legislation restricting foreign ownership in sectors of the economy deemed to be national security sensitive, or in matters pertaining to the confiscation of foreign-owned assets during wartime. Most of the restrictive covenants dealing FDIUS--and there are few in comparison with other countries--date to the period immediately following World War I (House Report No. 96-1216, 1980, p. 136).[36] Some of the limitations dating to that period include restrictions

[36]For a list of restrictions on foreign direct investment in the U.S., see Appendix C.

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on foreign ownership in coastal shipping, mining leases on federal lands, air transportation, broadcasting, and hydropower facilities (Ibid, pp. 161-179; Lenrow, pp. 116-118). During World War II, the Trading With the Enemy Act was again used to confiscate German and Japanese assets, as well as those of some of the Axis-occupied countries (American Bar Association, p. 9). But for these incidents, the public remained largely indifferent to foreign direct investments in the U.S. As in 1919, the level of FDIUS remained dwarfed by American investment abroad--and this has remained the case until relatively recently.

After World War II, U.S. policy was motivated by the substantial and increasing volume of outward bound investment, led by the growth of U.S. multinational enterprises. For the most part, policy toward incoming investment was viewed as something that other countries had. In the 1960's, this stance was abandoned briefly while the U.S. experimented with capital export controls designed to ease balance-of-payments difficulties. Part of this policy shift was a new emphasis on attracting foreign portfolio investment (American Bar Association, p. 10).

5.2.1 Policy During the Nixon Administration

By 1973, continued balance-of-payments difficulties led to two devaluations and an administration that was openly solicitous of increased FDIUS. The U.S. Commerce Department was attempting to enhance the prospects for foreign direct investment by providing information and advice to foreign investors through it's "Invest in the U.S.A." program (U.S. Dept. of Commerce, 1973, p. 3). The Nixon-appointed Williams Commission had recommended only two years earlier

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that funding for the program be stepped up dramatically in order to further "draw the attention of potential foreign investors to the investment opportunities available in the U.S. market, and to the advantages of operating in this country" (Lea and Webley, 1973, p. 29). In 1973, President Nixon urged Japan to invest more in the U.S., through a speech made by U.S. Ambassador Ingersoll, citing the benefits to both nations of such investment (Mergers & Acquisitions, 1973, p. 61). At the same time, President Nixon made a more general invitation for increased investment (U.S. Dept. of Commerce, p. 2):

> Investments from abroad have consistently accelerated the growth of our national economy and contributed to the general well-being of our people. I wholeheartedly invite businessmen from throughout the world to undertake production in the United States. In addition to the vital economic advantages to both the investor's home country and our own, such expanded production investments in the United States can have equally far-reaching benefits in terms of furthering international friendship and in the work of building world prosperity.

Whether such entreaties accounted for a major change in FDIUS is doubtful. However, the post-devaluation dollar certainly made investing in the U.S. more attractive. Dollar surpluses which had accumulated abroad, especially in Japan and Germany also helped to boost foreign direct investment in the U.S. (Lenrow, p. 114).

In any case, the inflow of foreign direct investment nearly tripled in 1973, and the foreign direct investment position increased by 38.3 percent--seriously raising the hackles of both the the general public and Congress (U.S. Dept. of Commerce, August 1984, p. 65; Inouye, 1976, p. 597). Responding to public concerns, the Nixon Administration conducted a review of U.S. policy toward FDIUS in the same year

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(Kubota, 1982, p. 132). In spite of an inability to assess the scope and magnitude of FDIUS, the review concluded that an "open door" policy should continue, that FDIUS was not significant in comparison to the size of the U.S. economy, and "that the Administration should oppose any Congressional attempt to impose new restrictions" (Ibid). In connection with the review, William D. Eberle, Executive Director of the Administration's Council on International Economic Policy (CIEP), concluded (Hearing, September, 18, 1974, p. 30):

> The Executive Branch recognized the general problem of the quality of the available data with respect to investment by foreigners in this country and concluded that we needed more and better information in this area. [However,] We have enough information to be able to conclude that foreign investment poses no immediate threat to our security and economic well-being.

Incoming direct investment increased by 22.3 percent in 1974 (U.S. Dept. of Commerce, p. 65). The $280 million worth of new Japanese investments transacted in Hawaii between 1971 and 1974 aroused a furor, feeding local fears of a loss of control over important segments of the Hawaiian economy--especially the travel industry (U.S. Dept. of Commerce, March 1980, pp. 22-24). As well, increasing Japanese investment in the West was causing concern, as were increased dollar holdings by OPEC nations and fears for the political and economic implications of investments by such countries. Also, concerns were raised about "various, often undocumented, reports of foreign takeovers in process or in prospect, and the apparent absence of a coherent national policy" (American Bar Association, p. 12).

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5.2.2 Policy Towards FDIUS in the Ford Administration

The year 1974 witnessed more than just additional record inflows of foreign capital. Before the year was out, President Nixon had resigned in the wake of the Watergate scandal and the presidential reigns were passed to then Vice President Gerald Ford. President Ford responded to the rising alarm over foreign direct investment in the U.S. with a 1974-1975 reevaluation of the U.S. "neutrality" posture with respect to FDIUS (House Report, p. 134). The reevaluation confirmed the Ford Administration's view that "existing restrictions on foreign direct investment were sufficient" and concluded that no changes were necessary. However, the Administration did concede the need for more "extensive, timely data" to conduct "informed analyses of the issue" (Ibid; Wilson, 1983, p. 2).

CIEP's William Eberle summed up the basic policy of the Ford Administration toward foreign investment (Hearing, p. 30):[37]

> The basic thrust of U.S. international investment policy is to encourage the free flow of capital as a means of maximizing the operating efficiency of the world economy. In accordance with this general principle, we admit foreign investors freely; we give them equality of treatment with domestic investors once they are established here; and we offer no special incentives and impose few barriers. The few restrictions we have imposed are well known and generally accepted abroad. We have opposed any attempts to add to the list of existing restrictions as unjustified by economic analysis--a position we will continue to adhere to unless it becomes evident that a particular measure is necessary on ground of national security or to preserve our essential national interests.

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[37]In 1974, the Ford Administration policy, as formulated by the Council on International Economic Policy, carried over from the policy review concluded in 1973 by the Nixon Administration.

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The Ford Administration supported the passage of the Foreign Investment Survey Act of 1974 (P.L. 93-479), which directed the the U.S. Commerce Department "to conduct a comprehensive, overall study of foreign direct investment in the United States," what was to become known as the "1974 Benchmark Survey of Foreign Direct Investment in the United States" (Hearing, p. 30; Wilson, p. 2). Probably more than anything else, such support was an attempt to forestall restrictions. After all, 70 different bills dealing with foreign direct investment were introduced in Congress between 1972 and 1976--many called for restrictions and prohibitions (Wilson, p. 2). In any case, the Ford Administration was nervous enough about the public relations fallout of signing the Foreign Investment Study Act, that President Ford made the following statement at the signing of the bill (Wilson, p. 13):

> As I sign this act, I reaffirm that it is intended to gather information only. It is not in any sense a sign of a change in America's traditional open door policy towards foreign investment. We continue to believe that the operation of free market forces will direct worldwide investment flows in the most productive way. Therefore my Administration will oppose any new restriction on foreign investment in the United States except where absolutely necessary on national security grounds or to protect an essential national interest.

Moves by other countries, especially Canada, to screen foreign direct investment, in an attempt to weed out that considered undesirable to national interests, may have proved influential in the U.S. Congress. Senator Howard Metzenbaum's (D-Ohio) Foreign Investment Review Act of 1974, which did not become law, was patterned in part after Canada's Foreign Investment Review Act of 1974, which did become law and created Canada's Foreign Investment Review Agency. Indeed, Sen. Metzenbaum cited recently promulgated Canadian and Australian investment screening laws in support of his bill (Hearing p. 19).

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Metzenbaum's bill and others, as well as developing concerns within the Administration about investments that could effect U.S. national interests (i.e., national defense, energy, transportation, etc.) led President Ford, in May 1975, to set up the Committee on Foreign Investment in the United States (CFIUS) (House Report, p. 134; U.S. Dept. of Commerce, p. 81). Announcing the proposed-CFIUS to a Senate committee on March 4, 1975, Treasury Undersecretary Jack Bennett said (Bergsten, 1980, p. 245):

> It is our belief that the policy and arrangements we are proposing will simultaneously safeguard our national interest and, by clarifying the situation, actually enhance the attractiveness of the United States for foreign investors.

Established by Executive Order 11858, CFIUS was created as an interagency group, chaired by a representative of the Secretary of Treasury. The Committee was vested with the "primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment" (House Report, p. 991). The establishment of CFIUS was designed, at least in part, to relieve some of the political pressure for review of foreign investments, as was being done increasingly by other countries. Unlike Canada's Foreign Investment Review Agency (FIRA), established the previous year, or the screening procedures of other countries, CFIUS was not authorized to establish entry requirements. Nor was it authorized to change the basic U.S. "open door" policy (Bergsten, p. 245).

Delivery of the reports on the 1974 Benchmark Survey, in 1976,

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helped to alleviate some fears concerning FDIUS, and no restrictive legislation was passed in the Congress. However, the Congress was prompted to authorize continued research through the International Investment Survey Act of 1976 (P.L. 93-479) (U.S. Dept. of Commerce, p. 20; Wilson, p. 2). The Act directed the President to set up a "regular and comprehensive data collection program" and to perform occasional benchmark surveys of the kind provided for in the 1974 Act (Wilson, op. cit.). The Act also called for an evaluation and feasibility study for monitoring agricultural and other real estate. The 1976 Act was the basis for the annual FDIUS surveys that have been undertaken by the Commerce Department's Bureau of Economic Analysis (BEA) ever since, as well as the 1980 benchmark study.

5.2.3 Policy During the Carter Years

Like its predecessors, the Carter Administration initiated a review of U.S. foreign investment policy on assuming office. Conducted by the administration's Economic Policy Group, the review resulted in the issuance of a statement upholding a long-time U.S. commitment to "an open international economic system"--the open door (Bergsten, p. 241):

> The fundamental policy of the U.S. Government toward international investments is to neither promote nor discourage inward or outward flows or activities.
>
> The Government therefore should normally avoid measures which would give special incentives or disincentives to investment flows or activities and should not normally intervene in the activities of individual companies regarding international investment. Whenever such measures are under consideration, the burden of proof is on those advocating intervention to demonstrate that it would be beneficial to the national interest.

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According to C. Fred Bergsten, Assistant Secretary for International Affairs at the Department of Treasury during the Carter Administration, there are four basic premises for such a policy (Ibid):

> First, international investment will generally result in the most efficient allocation of economic resources if it is allowed to flow according to market forces. Second, there is no basis for concluding that a general policy of actively promoting or discouraging international investment would further the U.S. national interest. Third, unilateral U.S. government intervention in the international investment process could prompt counteractions by other governments, with adverse effects on the U.S. economy and U.S. foreign policy. Fourth, the United States has an important interest in seeking to ensure that established investors receive equitable and nondiscriminatory treatment from host governments.

To the extent that the policy has largely persisted across administrations, the fourth reason is probably the most important. During the postwar period--at least until recently--the magnitude of outward bound U.S. foreign direct investment has far exceeded that of inward investment, and it has driven U.S. policy. The interest in nondiscriminatory treatment has been motivated by a desire to prevent discriminatory treatment by other countries against U.S. foreign direct investments.

In 1976, the Organization for Economic Cooperation and Development (OECD), an association of 24 developed countries to which the United States is a signatory, issued a "Declaration and Related Decision on National Treatment" (Ahearn and Driscoll, 1982, p. 31). The Declaration states that OECD member countries should accord "national treatment" to foreign investors. National treatment is a policy of treating foreign investors no less favorably than domestic investors.

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The U.S. has proposed extending and refining the national treatment principle "with a view toward greater acceptance of its principles by more countries" (Ibid). The U.S. has also negotiated many bilateral "Treaties of Friendship, Commerce, and Navigation" (FCN Treaties) during the postwar period which also guarantee national treatment for each countries investors in the other country (American Bar Association, pp. 25-26). The 1976 OECD Declaration also contained language concerning investment incentives and disincentives with respect to this issue of national treatment. A consultative procedure was created for handling situations in which an OECD member might consider itself injured by another member's investment incentives or disincentives (General Accounting Office, 1980, p. 46).

The issue of national treatment also caused officials within the Carter Administration to take a fresh look at investment incentives, both internationally and within the U.S., which might discriminate between classes of investors and result in a discriminatory backlash. Said Assistant Treasury Secretary Bergsten, "...governments at both federal and subfederal levels frequently adopt measures (incentives) which can distort the allocation of investment among nations, reduce the potential gains from international specialization, and prompt countermeasures by other governments" (General Accounting Office, p. 45). The Treasury Department voiced concern about the increasing use incentives by states to attract foreign direct investments, and even tried to get states to trim back the incentives being offered (Ibid, p. 31; Maloney, 1979, p. 29). The Treasury and State Departments also opposed federal provision of assistance of any kind to foreign investors on the same grounds (House Report, p. 135). Concerns about federal assistance to foreign investors led U.S. embassies overseas to assign a low priority to

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helping states attract foreign investment, a role which became limited primarily to referring investment prospects to states for further assistance (General Accounting Office, p. 21). Treasury also played a role in trying to cut back or eliminate the Commerce Department's "Invest in the U.S.A." program, which offered information and facilitative services to potential foreign investors (House Report, pp. 185-186). In early 1977, the "Invest in the U.S.A." program had seven professional staffers and a secretary. Not very long after that, it was cut back to two professionals and no secretary, its offices were moved, and its phones were unlisted. The office was only saved from termination after the intervention of several congressmen. In spite of this, in 1980, the office still had just two professionals and one secretary (Ibid).

A dramatic upsurge in foreign direct investments in the late 1970's fueled additional public and Congressional concerns, and led to additional calls for restrictions in such areas as foreign purchases of U.S. farmland and banking. Carter Administration officials were quick to react negatively to such measures. Assistant Treasury Secretary Bergsten opposed measures, in congressional testimony, to improve data collection efforts with respect to foreign purchases of farmland, and with respect to foreign investment in general (House Report, p. 168; Rosenstein, 1979, p. 3). Bergsten warned in 1979 that additional data collection requirements would be interpreted as a change in the prevailing open door policy and could be met by reprisals abroad (Rosenstein, p. 3). Nonetheless, President Carter did sign the Agricultural Foreign Investment Disclosure Act of 1978 (P.L. 95-460), which required foreign investors to report holdings of agricultural land, and the preparation of an annual report by the Agriculture Department

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on the impacts of such holdings on rural areas (U.S. Dept. of Commerce, p. 82). Also, in response to concerns about foreigners tax advantages in purchasing farmland and other real estate, the Revenue Act of 1978 contained a requirement for the Secretary of Treasury to report to Congress on the appropriate tax treatment of capital gains in real estate transactions involving foreigners (American Bar Association, p. 18). An attempt to close a loophole on capital gains tax treatment for real estate transactions involving foreigners was passed into law as the Foreign Investment in Real Property Tax Act of 1980 (P.L. 96-499) (U.S. Dept. of Commerce, p. 82).

Despite warnings and pleas from various federal officials, including Bergsten, the Congress also passed and President Carter signed legislation in 1980 to provide for a three-month moratorium on foreign takeovers of U.S. banks while a report was prepared for Congress on the issue (Ibid; Zupnick, 1980, pp. 56-58; Cowles, 1979, p. 1).[38] This occurred two years after the passage of legislation designed to "narrow the gap in Federal regulatory treatment between foreign and" domestic-owned banking institutions in the U.S. (U.S. Dept. of Commerce, p. 81).

Pressure built up in Congress in 1979 to modify Executive branch policy-making with respect to FDIUS. The Committee on Foreign Investment in the U.S. (CFIUS) had met only nine times since its inception up until 1979, and the Treasury Department, which chaired the committee, continually expressed a reluctance to review policy with respect to specific investments, or in general (House Report, pp.

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[38]The Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221).

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164-165). In fact, during Carter's first year and a half in office, CFIUS did not meet at all. Treasury Under Secretary Carswell and Assistant Secretary Bergsten apparently felt that convening the committee would serve notice on foreign investors of a change in administration policy (Ibid, p. 165). Furthermore, once the committee was ressurected, CFIUS removed private and portfolio foreign investments from its purview and--except for a review of a proposed Iranian investment in Occidental Petroleum in mid-1976--CFIUS reviewed no investments whatsoever. CFIUS also opposed legislation which was strictly designed only to gather information about foreign investment; it had opposed the International Investment Survey Act of 1976, during the Ford Administration, and it opposed the Agricultural Foreign Investment Disclosure Act of 1978 (Ibid, pp. 173-182).

Congressional pressure resulted in President Carter's Reorganization Plan No. 3, which among other things gave the U.S. Trade Representative the lead role in FDIUS policy formulation (Kudrle and Bobrow, 1982, p. 365; Ahearn and Driscoll, p. 7; Ibid, p. 183). President Carter's accompanying statement said (House Report, p. 183):

> The Trade Representative will have the policy lead regarding issues of direct foreign investment in the United States, direct investment by Americans abroad, operations of multinational enterprises, and multilateral agreements on international investments, insofar as such issues relate to international trade.

Nonetheless, the U.S. Trade Representative failed to take a lead role in FDIUS policy and the the concluding days of the Carter Administration ended in policy disarray. In a virtual turnabout from the previous administration policy of neutrality, the Secretary of Commerce announced in May 1980 a new policy initiative on foreign direct investment--one which received presidential approval (Ibid, p. 189):

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> [I]t shall be the policy of the Federal Government in the near future to encourage foreign investors, once they have decided to invest in the U.S., to consider locating in distressed urban and rural communities. Implementation of this policy will increase the likelihood that foreign investment will contribute to the economic revitalization of distressed urban and rural communities and expand their job and tax bases.

Under the new policy federal agencies were requested to do the following (Northeast-Midwest Institute, 1982, p. 93):

- provide foreign investors with general information about incentives available for investment in distressed communities. In cooperation with state and local governments, the federal Departments of Commerce, Housing and Urban Development, Agriculture, Labor, State, and the Treasury were to prepare materials detailing the economic development and employment and training programs available to investors who choose to locate in distressed communities;

- encourage states to use their foreign investment programs to emphasize to foreign investors the advantages of investing in distressed communities and provide state and local agencies with technical assistance to help them incorporate foreign investment opportunities into local development strategies;

- analyze foreign direct investment and its potential for spurring local revitalization efforts; and

- review existing regulations and procedures to insure equitable treatment of foreign investments and eliminate impediments to the use of federal assistance by foreign investors in distressed communities.

In spite of the announcement, there is little to suggest that this policy or any other policy with respect to foreign direct investment in the U.S. was ever fully implemented.

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5.3 FDIUS Policy During the Reagan Administration

5.3.1 Introduction

The explicit, stated policy of the Reagan Administration towards FDIUS has changed little over that of previous administrations. It has largely been a continuation of the stance taken by prior presidencies, namely one of neutrality--the so-called "open door." Most of the efforts of this Administration concerning foreign investment have, indeed, traded on this open door policy in an attempt to reduce restrictions and performance requirements placed on U.S. investments in other countries.[39]

However, as public and government concern has grown over the implications of certain investments, and as principal allies have attempted to implement or retain policies in conflict with this concept of "neutrality" toward the flow of international investment, U.S. policy has come under fire from both within and outside of the government. Like previous administrations, the Reagan Administration has long been attacked by those who claim that a policy of "neutrality" is really not a policy at all and may be quite harmful to U.S. interests in the long run. At times, these voices have been heard from within the Administration, itself. Even as recently as March of this year, one Cabinet-level official pledged himself to an overhaul of U.S. policy towards FDIUS.

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[39]These efforts have centered on the Bilateral Investment Treaty (BIT) program, which has had the aim of pledging other nations, mostly underdeveloped, to policies of reciprocity in the treatment of U.S. investments.

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While Administration policy has for the most part lived up to its name, it has not been one of strict neutrality. Rather, the Reagan Administration or elements within the Administration have acted in a number of instances to block foreign investments, or interfere with foreign investments to a degree unheard of during previous administrations. Unfortunately, it is not clear that such actions have added coherency to Federal policy and previous Congressional criticisms have largely gone unanswered, as became poignantly clear during recent Congressional hearings. Nonetheless, efforts have been underway to formalize alternatives to the "neutrality" posture of the Federal government and Congressional efforts to modify Federal data collection and treatment of foreign investors have continued. A number of events help to illustrate some of the responses of government policymakers in recent years, as well as the shifts in policy, which have occurred during the term of the Reagan Administration.

5.3.2 Early Criticism of Administration Policy

Ronald Reagan became president only months after the release of a major Congressional report on Federal policy towards and monitoring of FDIUS. The report sharply criticized Federal data collection, analysis, and reporting of foreign investment. Federal efforts were described as "so inadequate, disjointed, and poorly implemented that Federal estimates of the total amount of FDI constitute little more than guesswork." (House Report, pp. 19-20). The report also pointed out the U.S. policy of "neutrality" placed U.S. economic and political interests in jeopardy because it does not distinguish between beneficial and harmful investments, does not distinguish between economic and political investment motives, and concedes economic decision-making to interests located outside of the United States.

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As the first few months of the Reagan term unfolded, responses began to roll in from some of the Federal agencies that had been criticized in the report. While some agencies agreed that data collection and analysis could be improved, there was a general resistance to most of the suggested changes, especially concerning policy.

"While a few of the...recommendations have been adopted, the federal agency responses...turn a deaf ear to the concerns of the Congress and the public over the growing dangers of certain types of foreign investment," said Rep. Benjamin S. Rosenthal, a member of the House Government Operations Committee, which released the report (Waters, 1981). He added, "Where such investment fails to bring with it new jobs and venture capital, or where it threatens control of essential sectors of our economy, the government must monitor and, if necessary, restrict unwanted investment as other industrialized nations do."

While little response was forthcoming from the Administration, it was already receiving public and congressional flak over its policy from a case involving a hostile takeover attempt of an Ohio manufacturer by Canadian-based Canadian Pacific Enterprises, Ltd.

5.3.3 Foreign-Source Financing of Foreign Acquisitions

At a time of increasing of concern over the operations of Canada's Foreign Investment Review Agency, as well as a persistent merchandise trade deficit with Canada, the hostile takeover attempt of a major U.S. manufacturing exporter by a Canadian multinational in early 1981 aroused a storm of controversy. The U.S. firm was Hobart

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Corporation, an Ohio-based manufacturer of kitchen equipment, with employment of 9,000 in U.S. based plants, and export sales of $173.4 million (United Press International, February 12, 1981; and Associated Press, February 16, 1981). The Canadian firm was a unit of Canadian Pacific Enterprises, Ltd., the largest Canadian conglomerate.

In a letter to Treasury Secretary Donald Regan, two congressman, Rep. Benjamin Rosenthal, D-N.Y., and Rep. Lyle Williams, R-Ohio, both members of the House Government Operations Committee, charged the takeover by Canadian Pacific would have "severe negative implications for...the U.S. economy" (United Press International, op. cit.). They charged threats to continued operation of Hobart plants in the U.S., threats to a large number of jobs, and threats to a substantial contribution made by Hobart to the U.S. balance of payments. Rosenthal and Williams requested that Regan initiate an inquiry into the deal by the interagency, Committee on Foreign Investment in the U.S., headed up by the Treasury Department. CFIUS declined to review the case, however.

Besides the resistance of Hobart to a hostile takeover, and a prevailing negative sentiment about increasing foreign acquisitions of U.S. firms, at issue was whether the U.S. government should discriminate in favor of foreign investors over U.S. investors. The discrimination issue came about because, while two U.S. banks, Chemical Bank of New York and Lincoln First National Bank of Rochester, N.Y., had agreed to put up the $75 million of the $500 million necessary to finance the takeover, Canadian Pacific planned to finance most of the acquisition from a foreign credit source (Ibid; New York Times, February 13, 1981, p. D3; Press Release, February 13, 1981) Rosenthal and Williams argued that

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the financing contravened Federal Reserve Policy against the use of borrowed funds to finance company acquisitions.

Under the Security and Exchange Act of 1934, as amended by Congress in 1970, American companies are subject to 50 percent domestic margin requirements in the purchase of domestic stocks. In other words, they may not borrow more than 50 percent of the market value of stock in an acquisition attempt. The domestic margin requirement was intended to prevent U.S. companies from borrowing abroad to finance domestic takeovers. However, through a loophole in the law, the domestic margin requirement does not apply to foreign investors, meaning that foreign investors can finance the total purchase price of a U.S. firm by borrowing overseas.

The Congressional response was not to wait for Administration action. During a Senate Judiciary Committee hearing on February 16, 1981, hastily thrown together at Sen. Howard Metzenbaum's (D-Ohio) request, the complaints raised by the acquisition attempt ranged from fears that United Auto Workers members would lose their jobs to anger over Canadian foreign investment impediments (Associated Press, op. cit.). Perhaps the most significant outcome of the three-hour hearing was that Sen. Strom Thurmond, R-S.C., chairman of the committee, threatened a move to change federal antitrust laws to prevent takeovers of this kind. In the meantime, two other Ohio congressman had also asked the House Judiciary Committee to investigate the antitrust implications of the Hobart acquisition.

On the House side, the Subcommittee on Telecommunications, Consumer Affairs and Commerce, held hearings on February 26, 1981,

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specifically dealing with the issue of margin requirements and foreign financing of acquisitions. On the table was legislation proposed by Rep. Clarence J. Brown, R-Ohio, which would tighten credit regulations for foreign investors in the United States (Press Release, op. cit.). The purpose of the proposed legislation was to insure that foreign investors were placed on the same footing as domestic investors, when it came to financing acquisitions, by placing 50 percent margin requirements on loans from overseas banks undertaken for the purpose of acquiring securities of U.S. companies. Rep. Jack Brooks, D-Texas, one of the proposal's sponsors, said that he could not understand why anyone "in his right mind" would favor a competitive advantage for foreign firms over domestic firms (Associated Press, February 26, 1981).

The response from Federal officials was different. Trotting out the "neutrality" policy, J. Charles Partee, a member of the Federal Reserve Board--the agency responsible for enforcing margin requirements--said that the proposed margin requirements for foreign investors would amount to "new barriers to the free flow of capital," and that foreign financial institutions would consider the measure to be unwarranted "intrusion into their affairs" (Ibid). Partee also said that, "We at the board are not aware of any generalized adverse impacts from the acquisition activities of foreign investors." An Administration witness, Brant W. Free, Acting Deputy Assistant Secretary for Finance, Investment and Services, stated that (Hearings, February 26 and April 2, 1981, pp. 56-58):

> Our overall policy should...remain one of maximum openness, regardless of the position assumed by other countries....
>
> [Also,] some countries would be likely to consider [tightening

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> of margin requirements on foreign-source financing] as a tightening of U.S. inward-investment controls....
>
> [This] would...send the wrong signal to our trading and investing partners regarding our attitude toward international investment flows.

Not long after the February hearings, Canadian Pacific ended its hostile takeover attempt when Hobart Corporation allowed itself to be merged in a friendly agreement with a U.S.-owned company (Ibid, p. 136). Congressional legislation to curb abuse of foreign financing for acquisitions of U.S. firms died. However, the controversy about foreign investments failed to die. If anything, the Hobart takeover attempt was only an opening shot in the battle for a new foreign investment policy agenda.

5.3.4 Reciprocity and Canadian Direct Investment

In mid-1981, Congressional ire was being raised by increasingly restrictive investment policies on the part of Canada and Canadian attempts to acquire U.S. energy and mineral companies. Congress became involved in Canadian investment policy when Joseph E. Seagram and Sons, Inc., a Canadian-owned firm made an attempt to acquire the U.S.-based St. Joe Minerals Corporation (Corrigan, 1981, p. 1369). Members of the Missouri delegation quickly introduced legislation to protect St. Joe, which had mining operations in Missouri. Although the bid was foiled when another U.S. firm, Fluor Corporation, made an offer for the St. Joe, similar moves were afoot by other Canadian firms--even as Canadian Prime Minister Pierre Trudeau's new National Energy Program was threatening to put U.S.-owned firms out of business in Canada.

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Canada's National Energy Program, announced late in 1980, had a number of objectives, including increasing Canadian ownership of the revenues derived from oil and gas production in Canada from 28 percent to 50 percent by 1990, significantly expanding public ownership in the industry, and increasing the extent of Canadian participation in the industry (Safarian, 1985, p. 42 and 1983, p. 16). U.S. firms became targets because they had long dominated the Canadian oil and gas industry. Nine of the top ten and 17 of the top 25 firms in the industry were owned by foreign interests, and all but a few were in U.S. hands (Corrigan, op. cit.). The new policy was seen in the U.S. as an abrupt departure from the "traditionally wide-open business and trade relationships" between the U.S. and Canada (Ibid).

The Energy and State Departments responded to congressional inquiries by saying that they shared congressional concerns and were studying the matter. However, the State Department, through Richard Fairbanks, the Assistant Secretary for Congressional Relations, cautioned against proposing restrictions on similar Canadian investment in the U.S. (Inside Energy/with Federal Lands, June 26, 1981, p. 8):

> In developing policies toward investment in the U.S. minerals sector, we must take into account the fact that the U.S. is the largest investor in foreign countries and has been a major force in world mining development. In the future the United States is likely to be increasingly reliant on imports for a number of crucial raw materials, and it is apparent that we continue to have a major interest in maintaining maximum freedom on investment and capital flows in world mining. In this regard, United States' policies concerning foreign investment in the U.S. minerals sector will have a significant impact on the policies of other countries. Imposition of U.S. restrictions could invite retaliatory actions by others. Therefore, we must proceed cautiously in considering and adopting policies which would restrict inward investment.

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The reply from State did not quiet Congressional concerns. In July 1981, Rep. Michael Synar (D-OK) and Rep. Robert Whittaker (R-KS) introduced a bill to impose a nine month ban on Canadian acquisitions of U.S. energy firms and require the development of a federal policy on foreign investment in the U.S. energy-producing sector (Industry Week, July 13, 1981, p. 110). In the meantime, testifying before two subcommittees of the House Energy Committee, Treasury Undersecretary Beryl Sprinkel and Assistant Secretary of State Robert Hormats indicated that Canadian diplomats remained unmoved by pleas for reciprocal treatment for U.S. firms (Oil & Gas Journal, July 20, 1981, p. 28). While Sprinkel still advised against restrictive legislation, he indicated that Interior Department had been asked to expedite a review of whether Canadian-owned firms would remain eligible to purchase federal mineral leases in the U.S. Hormats indicated that strong pressures were building to deny such leases to Canadian-owned firms under the authority of the 1920 Mineral Lands Leasing Act. The Act permits foreign-owned firms to engage in exploration and production on U.S. leases if U.S. firms have similar rights in their countries. At the same time, the Administration's Trade Policy Committee, an interagency group of 14 cabinet-level agencies, was reviewing other possible measures, including invoking certain provisions of the General Agreement on Tariffs and Trade (GATT) that restrict discriminatory actions by countries that have signed the agreement (Chemical Week, July 29, 1981, p. 11). Another working group was established under the aegis of the Cabinet Council on Economic Affairs (CCEA) to review Administration policy toward FDIUS (Corrigan, op. cit.). Also, CFIUS began compiling data on Canadian investments in the U.S.

In August, the Administration appeared to do an about-face on

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the idea of refusing Canadian firms U.S. mineral leases under the Mineral Leasing Act of 1920. On August 6th, James Watt, Secretary of the Interior, promised Congress that his department would determine within 120 days whether Canada had forfeited eligibility for U.S. mineral leases under its new energy policy (Roby, October 14, 1981). However, testifying before the House Energy and Commerce Committee's Oversight and Investigation Subcommittee, Watt expressed reluctance to declare Canada nonreciprocal, regardless of the outcome of the review (Oil & Gas Journal, August 17, 1981, p. 68). Watt said that declaring Canada nonreciprocal for purposes of the 1920 Act might affect at most $1.3 billion in Canadian investments, while threatening retaliation against a $8.6 billion U.S. investment in the Canadian oil industry. Incensed at the length of the 120 review process that Secretary Watt had indicated, the subcommittee's chairman, Rep. John Dingell (D-MI) had subpoenaed documents relating to Interior's review and received some as of September 24th. Secretary Watt indicated in a letter to the panel that some of the documents had been withheld "to protect the deliberative processes and the nation's conduct of foreign policy" (Ibid). In an October appearance before the committee, Watt produced a presidential memorandum asserting "executive privilege" in the interests of protecting foreign policy negotiations. Not long afterward, Dingell's threat of a contempt citation against Watt resulted in a White House decision to allow subcommittee review of the documents (Peterson, 1982, p. A6). In February 1982, Secretary Watt released a determination that Canada had met U.S. reciprocity requirements under the Mineral Lands Leasing Act of 1920 (Roby, February 4, 1982).

According to Assistant Treasury Secretary Marc Leland, Secretary Watt's determination was technically correct (Hearing, February 23, 1982, pp. 50-51):

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> ...Secretary Watt recently determined that Canada is reciprocal under the Mineral Lands Leasing Act of 1920....This Act mandates the [U.S. government] to retaliate against citizens of a nation whose policies in one particular area are found to discriminate against U.S. citizens. In making his decision, Secretary Watt found that Canadian laws do not deny Americans the privilege of owning stock in Canadian oil and gas companies and, therefore, Canada could not be found reciprocal under the provision. This determination was made within the narrow, technical confine of the provision....
>
> Granting Canada reciprocal status should not in ay way be interpreted as U.S. government acquiescence of Canadian investment policies. The administration continues to be seriously disturbed by Canada's discriminatory investment policies, embodied in the national energy program (NEP) and in the operations of the Foreign Investment Review Agency (FIRA). [We are] pursuing these issues bilaterally, in the Organization for Economic Development (OECD), and in the General Agreement on Tariffs and Trade (GATT)....The U.S. Government continues to press for changes in the NEP and in the FIRA....

Ironically, while Congress considered various forms of reciprocity legislation, Canadian investors appeared to be pulling out of U.S. petroleum. The Canadian position in the U.S. petroleum industry declined from 15 percent of all foreign investment to seven percent between 1980 and 1983 (Dept. of Energy, 1985, p. 8). This was accompanied by a decline in Canadian investment in the petroleum industry from $1.82 billion to $1.37 billion. The U.S. Dept. of Energy concluded that "new incentives and opportunities" for Canadian producers in Canada, as a result of the Canadian energy program, were drawing Canadian investment away the U.S. (Ibid).

Although it was probably not related to any specific initiatives

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on the part of the United States, and while Canada's National Energy Program was not affected, some general tension in the U.S.-Canadian investment relationship was probably lifted in 1985. Brian Mulroney's newly elected Conservative government in Canada proposed legislation that year to lift restrictions under the Foreign Investment Review Agency (FIRA) (Gordon and Lees, 1986, p. 235). FIRA's replacement, approved by Parliament in August 1985, was a new agency called "Investment Canada," whose express purpose was to seek and facilitate additional investment.

5.3.5 Questions About Government-Owned Multinationals

The election of a Socialist government in France in 1981 was treated with particular disdain by the Reagan Administration, as were France's plans to nationalize major segments of the French economy. The Socialist government raised new concerns for the administration about the operation of government-owned French multinationals in the United States. These concerns were brought to the fore in 1981 by Elf Aquitaine's tender offer for Texasgulf. Interestingly enough, the tender offer grew out of Elf's problems with Canada's National Energy Program. In 1981, Societe Nationale Elf Aquitaine owned 75 percent of Aquitaine Co. of Canada, a large oil and gas company (Tinnin, 1981, p. 90). Under Canada's new National Energy Program announced the previous year, Canada was offering subsidies to energy companies whose stock was held primarily by Canadians. Faced with a situation which promised to radically affect the profitability of Elf operations in Canada, Elf preferred to sell its Canadian operations. However, Elf wished to maintain a strong presence in North America.

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The potential for a deal came about because the Canadian government-controlled Canada Development Corporation (CDC) then controlled 37 percent of U.S.-based Texasgulf (Ibid). Elf Aquitaine agreed to sell its Canadian holdings to CDC for about $1.5 billion and CDC's share of Texasgulf. Elf quickly purchased additional stock, increasing its interest in Texasgulf to 87 percent within one month. The interagency Committee on Foreign Investment in the U.S. (CFIUS) reportedly became interested because of concerns over the political orientation of the French government and the question of government control. Beryl Sprinkel, Under Secretary of the Treasury for Monetary Affairs said, "There is a real question of whether a government-controlled company will act the same way as a private one....That is something we cannot ignore" (Ibid).

The Reagan Administration was concerned enough about the French purchase that Marc Leland, Assistant Treasury Secretary for International Affairs and chairman of CFIUS, made a formal request to the French government to delay the purchase so that the committee could have enough time to review the transaction (Farnsworth, 1981, p. D5). However, Philippe Faure, press attache to the French embassy in Washington said that Elf Aquitaine was independently managed and did "not accept any instructions from the French government" (Jacobsen, 1981). French President Mitterand also transmitted a reply to the U.S. request: "I hereby confirm that this is purely a commercial transaction. Therefore the French government has no intention of intervening" (Tinnin, op. cit.). CFIUS indicated its inability to hold up the investment through lack of statutory powers, even though it was concerned, and the sale went through--one of the largest acquisitions of U.S. companies on record (U.S. Dept. of Commerce, March 1983, p. 32).

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Partly in response to the Texasgulf deal and tensions over Canada's National Energy Program, a House Interior subcommittee voted in July 1981 for a nine-month moratorium on all foreign takeovers, retroactive so as to cancel the Elf Aquitaine-Texasgulf deal (Farnsworth, op. cit.). In the end, the legislation was not passed. Concern over government-controlled foreign enterprises did not stop there, however. Concern was sufficiently great that CFIUS limited its review of FDIUS transactions in 1981 solely to those involving foreign government-controlled enterprises (Hearing, pp. 47-49). Additionally, in 1981-82, the Cabinet Council on Economic Affairs (CCEA) was concentrating its review of foreign investment policy in the same area. According to Assistant Treasury Secretary Leland, CCEA's review was (Ibid, p. 50):

> ...concentrated on three areas...; the broad implications of government-controlled investment for U.S. interests, the adequacy of the CFIUS for dealing with such investments, and the implications for U.S. interests of the foreign government investments which arise from the French nationalization program.
>
> One of the major questions the CCEA is considering, particularly in regard to its examination of the CFIUS, is whether additional legislative authority to review or restrict foreign investment in the United States is necessary at this time.

5.3.6 Here Come the Arabs: Kuwaiti's Purchase of Santa Fe International Corp.

Another foreign takeover of a U.S. energy concern in 1981 contained elements of both the reciprocity problems under the Mineral Lands Leasing Act of 1920 as well as increasing concern over

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government-controlled foreign enterprises. It also involved the largest purchase ever of an American firm by a Middle Eastern nation and provoked fresh outcries about the dangers of OPEC investment in the United States. As well, elements of the transaction came under close scrutiny for national security reasons, something which was to become of increasing importance later in the Reagan Administration.

The deal involved an October 1981 announcement by the Santa Fe International Corporation that they had agreed to an acquisition by Kuwait's state owned oil company, subject to stockholder approval on December 1st (Lippman, October 6, 1981, p. A1). The estimated transaction price of $2.5 billion set a new record for the size of investment by an OPEC member, and followed on the heels of several other large investments by the Kuwait Petroleum Corp. in energy-related U.S. companies (United Press International, October 6, 1981).

Rep. Benjamin Rosenthal (D-NY), whose subcommittee of the House Government Operations Committee had concluded hearings on OPEC investments in the U.S. only the week before, rapidly fired off telegrams to Treasury Secretary Donald Regan and Securities and Exchange Commissioner John Shad requesting an investigation (Lippman, op. cit.; Crutsinger, 1981). Rosenthal warned that allowing an OPEC member to purchase oil exploration and production capacity outside of its own country would "enormously expand" the cartel's influence (Crutsinger, op. cit.). Two weeks later, Assistant Treasury Secretary Marc Leland told Rosenthal's subcommittee that a review was in progress. "I am concerned...that investments by foreign governments could be politically motivated or that such entities could enjoy special advantages over their private competitors," he said (Barton, 1981).

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While indicating that CFIUS had no particular objections to the Santa Fe-Kuwait Petroleum Corp. merger, Leland told the subcommittee that CFIUS needed enhanced powers to police such transactions (Platt's Oilgram News, October 21, 1981, p. 4; Oil & Gas Journal, November 2, 1981, p. 228). Leland also indicated that the Interior Department was examining Kuwaiti mineral leasing laws to see if American investors enjoyed reciprocal investment rights in Kuwait. Questions about national security were also raised by the panel, including the question of whether the Kuwaiti's might use the acquisition of the firm to transfer sensitive nuclear technology from a Santa Fe subsidiary involved in nuclear contracts. Santa Fe Senior V.P. James Ukropina indicated that the Kuwaiti's had agreed to follow U.S. laws and regulations concerning the transfer of such technology (Engineering News-Record, October 29, 1981, p. 75).

A report prepared by Congress' Office of Technology Assessment (OTA) in November 1981 warned that the Kuwait-Santa Fe deal could thwart U.S. efforts to control the spread of nuclear weapons (Miller, 1981, p. D13). The report found that the nuclear and military work conducted by C.F. Braun & Company, the Santa Fe subsidiary, "would be of use to any nation that wishes to produce nuclear weapons" (Ibid). Reagan Administration responses in the matter were somewhat contradictory. Marlin Fitzwater, Deputy Assistant Secretary for Public Affairs at the Treasury Department, characterized Treasury's attitude as one of "general concern" (Ibid). Richard Perle, Assistant Secretary of Defense for National Security Policy, also raised concerns in a letter to Rep. Rosenthal (Lippman, November 28, 1981, p. E1). However, State Department cables and other U.S. government officials indicated that senior Administration officials had been supportive of the acquisition

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from early on. One of those described as "sympathetic" to the Kuwaitis was Interior Secretary James Watt (Miller, op. cit.).

In early December, the Treasury Department announced that CFIUS had found that the acquisition "did not have major negative implications for United States national interest[s]" (De Silva, 1981). Assistant Defense Secretary Richard Perle, also a member of CFIUS, signed off on the announcement, indicating that his objections on national security grounds had been satisfied, even while Santa Fe was still negotiating with the Energy Department on the formation of a voting trust to insulate C.F. Braun technology from the new Kuwaiti owners (Lippman, December 5, 1981, p. D9). The Justice Department also announced that the takeover would not violate U.S. antitrust statutes. Within hours of the Justice Department decision, on December 4th, Kuwait and Santa Fe filed the final merger papers on the transaction. Rep. Rosenthal was apparently surprised by the announcement and promised to convene another hearing on the matter.

At Rosenthal's subcommittee hearing on December 9th, Energy Department Department Assistant Secretary Troy Wade indicated that the department was in the process of retrieving unclassified sensitive documents from C.F. Braun (Platt's Oilgram News, December 10, 1981, p. 3). Wade also said that the Santa Fe subsidiary had promised not to copy sensitive documents and to protect the classified documents remaining in the firm's possession. Assistant Attorney General William Baxter testified that he was satisfied that no anticompetitive issues were involved in the transaction. Having satisfied Justice Department questions in the case, it would have been impossible for Justice to have held open the case while DOE completed its study of the security

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aspects of the transaction, he said. Assistant Treasury Secretary Marc Leland indicated that an Administration working group was looking into the possible need for legislation to give CFIUS powers to block investments rather than just provide advice concerning them.

Meanwhile, House Energy and Commerce Committee Chairman Rep. John Dingell was concerned that the Mineral Lands Leasing Act of 1920 had not been considered during the Reagan Administration's review of the Kuwait-Santa Fe merger (Inside Energy/with Federal Lands, December 11, 1981, p. 3). Dingell's concerns were based on the fact that U.S. citizens and companies would be prevented from owning or leasing mineral property in Kuwait because the Kuwaiti government had ceded these rights exclusively to the Kuwaiti Petroleum Corporation. Interior Secretary James Watt said that he could not render a determination until a full review of the 1920 Act's reciprocity provisions had been completed. Administration officials had indicated, however, that Secretary Watt was predisposed to grant reciprocal status to Kuwait under the Act (Ibid).

Fully one year later Secretary Watt had still not made an official determination in the Kuwait-Santa Fe case, though he had determined Canada to be reciprocal under the Mineral Lands Leasing Act the previous February (Peterson, 1982, p. A6). Decisions on reciprocity under the act for Cyprus and Sweden followed in the intervening months, while as in the case of Canada, both nations restricted similar foreign investment. In December 1982, Administration sources were claiming that Watt was close to a decision to grant reciprocity to Kuwait. However, it was not until the following March that Watt released a surprising decision. Secretary Watt declared

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Kuwait to be a "non-reciprocal" nation under the Mineral Lands Leasing Act because of discrimination "against U.S. citizens and corporations" (Sangeorge, 1983). Watt based his decision on the fact that since the 1970's, Kuwait had not allowed U.S. interests to hold petroleum concessions while Japanese, British, Dutch, and Spanish interests were allowed concessions. Watt said at a news conference that "...we are committed to free trade that works in both directions, [so] we cannot condone a practice which shut[s] out Americans while allowing access to citizens and corporations of other nations" (Ibid). Watt's decision through into doubt the legality of oil and gas leases held by Santa Fe International Corp. While the status of Santa Fe's leases still had not been cleared up as of 1985, the determination effectively shut out Kuwaiti investors from acquiring new leases on federal lands (Mattione, 1985, p. 47).

5.4 Policy Review and the Reagan FDI Policy Declaration

While the Reagan Administration generally subscribed to the "open door" policy of neutrality with respect to foreign direct investment in its early years, the cases discussed in the previous section illustrate that there were a number of concerns affecting a review of Administration policy in the early Reagan years. These concerns led to statements by Administration officials, in 1981 and 1982 that the Administration was reviewing U.S. foreign direct investment policy and might seek or welcome powers to block certain types of investments.

On December 9, 1981, Assistant Treasury Secretary for International Affairs Marc Leland told the House Subcommittee on Commerce, Consumer and Monetary Affairs that the Administration was

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considering asking Congress to give the interagency Committee on Foreign Investment in the United States (CFIUS) more power over investments by foreign government-controlled companies in the United States (New York Times, December 10, 1981, p. D5). In January, Leland said that France's pending plans to nationalize major industries and Kuwait's new policy of direct state acquisitions in the U.S. raised new concerns about foreign government control of U.S. firms (Lippman, January 15, 1982, p.E1). These were cited as the reasons for a comprehensive review of U.S. policy towards FDIUS by the Administration. Leland said that foreign government controlled investment, "while not new in concept, is new in practice." Warned Leland, regulatory and antitrust actions "can quickly become a diplomatic incident" when state-owned enterprises are involved (Ibid). Said Leland (Ibid):

> Our basic policy is an open attitude toward the free flow of private foreign investment....The issue here is government-controlled investment as distinguished from private investment. What are the competing interests of governments if they own the banks and the industries? Should you look at it the same way as if individuals owned it?

An illustration of this new-found concern within the U.S. government can be seen in CFIUS' review of investments. During the Carter Administration, one investment was reviewed--a proposed investment by the Iranian government in a U.S. oil company was reviewed (Hearing, May 8, 1986, p. 144). By contrast, CFIUS reviewed five cases in 1981 alone (Hearing, February 23, 1982, pp. 48-49). Concern over investments by government-controlled enterprises has continued to be central to CFIUS reviews, at least through May of 1986, and CFIUS records show 24 investments reviewed from 1981 to

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early 1985, predominantly involving state-owned enterprises (Hearing, May 8, 1986, pp. 98 & 140-142).

While discussing Administration concerns in January 1982, Leland reported that almost all of the Cabinet-level departments were participating in the Administration's FDIUS review and would be making recommendations to the Cabinet Council on Economic Affairs (CCEA) within about six months (Lippman, op. cit.). More than six months later the review was still taking place. In a September 23, 1981 speech to the American Bar Association, Raymond J. Waldmann, Assistant Commerce Secretary for International Economic Policy, said that three proposals were being considered by the CCEA's working group to strengthen the interagency CFIUS (Daily Report for Executives, October 1, 1982, p. L-3):

- A more formal requirement for advance notice of investment to assure that all deals are identified and reviewed prior to closing....
- Establishment of upper limits on certain categories of investment such as energy and natural resources...
- Strengthening penalties for non-compliance with the review process through [modifications to] the International Investment Survey Act of 1976.

As part of the review process on FDIUS policy, the Commerce Department prepared a report on foreign direct investment by government-controlled firms. The report, released in March 1983, listed a number of concerns with the operation of foreign government-controlled companies (Commerce Dept., March 1983, pp. 6-8):

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- The 1976 International Investment Survey Act prevents public disclosure of the identification of foreign direct investors,
- Foreign-government controlled firms might "be subject to foreign political pressures designed to support their governments' foreign policy objectives,"
- State-owned enterprises might "be willing to sacrifice U.S. production [and jobs] to ensure full employment in their home countries during times of adverse...economic conditions,"
- Foreign government-owned firms "could create global cartels in such industries as petroleum and banking, as well as some manufacturing sectors,"
- Foreign government-controlled enterprises might enjoy tax advantages not available to domestic competitors,
- Foreign state-owned enterprises might siphon away valuable technology which has insured U.S. industrial superiority and national security.

The report presented counterarguments to many of these concerns and concluded that (Ibid, p. 11)

> ...while direct investment by foreign firms with foreign government shareholders is sometimes highly visible, it still accounts for a relatively modest portion of total foreign direct investment in the United States. Transactions involving [such] companies...accounted for 2.5 percent of the number of foreign investment transactions recorded from 1974 through 1981.

After the release of the report, talk of the possibility of providing CFIUS with powers for blocking or delaying investments died quietly within the Administration. Six months later, on September 9, 1983, President Reagan released a long-awaited policy statement on foreign direct investment (Statement by the President, September 9, 1983):

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I am releasing a major statement on international investment. This statement was developed by my Senior Interdepartmental Group on International Economic Policy, chaired by Treasury Secretary Regan, and encompasses the views of this administration on international investment....

The statement...enunciates the fundamental premise of our policy--that foreign investment flows which respond to private market forces will lead to more efficient international production and thereby benefit both home and host countries.

It also highlights three other important points. First, our concern with the increasing use of governmental measures to distort or impede international investment flows. Secondly, our strong support for the concept of national treatment which extends to foreign direct investors in the United States. And finally, an enumeration of specific multilateral and bilateral steps the administration has taken, and will take, to help liberalize international investment flows....

[Policy precept from the statement:]

The United States believes that an open international investment system responding to market forces provides the best and most efficient mechanism to promote global economic development. Government intervention in the international allocation of investment resources can retard economic growth.

[With respect to foreign direct investment in the United States:]

The United States has consistently welcomed foreign direct investment in this country. Such investment provides substantial benefits to the United States. Therefore, the United States fosters a domestic economic climate which is conducive to investment. We provide foreign investors fair, equitable, and non-discriminatory treatment under our laws and regulations. We maintain exceptions to such treatment only as are necessary to protect our security and related interests and which are consistent with our international legal obligations.

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Other than a fairly traditional restatement of U.S. "open door" policy with respect to FDIUS, perhaps the most significant phrase in the President's statement was the comment about "protect[ing] our security." Interestingly enough, following the release of the policy statement, U.S. actions on inward investment have seemed more motivated by national security and technology-related concerns than anything else.

5.5 National Security Concerns Come to the Fore

Richard Perle, Assistant Secretary of Defense for International Security Policy, had expressed reservations about the Kuwait-Santa Fe merger in 1981 on national security grounds, fearing a transfer of nuclear weapons-making technology. This was not the last incident in which foreign direct investors were confronted by a Defense Department, fearful of critical technology falling into or remaining in the wrong hands. Sometimes the Defense Department was able to block or dissolve investments, sometimes not. The examples that follow illustrate the increasing role of defense-related concerns in FDIUS policy.

Kyocera-Dexcel. A particularly interesting case occurred in 1983, when Japan-based Kyocera Corporation sold off one of its U.S. units, under Defense Department pressure. The situation was unusual because the investment was made in 1975--and Defense Department action did not come until 1983. The subsidiary, Dexcel, was established in the United States by Kyocera in 1975 (Japan Economic Journal, March 1, 1983, p. 2). Dexcel was engaged in the manufacture of chemical compound semiconductors, originally for civilian space and aeronautics uses. However, the company later got into U.S. military sales, and this is what got the firm into trouble. Among the products

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produced for the military was a "field-effect transistor," incorporated into the radar of the F-15 and F-16 fighter planes. Apparently concerned that the circuits could fall into the wrong hands, the Defense Department presumably invoked powers available under the Defense Industrial Security Program (DISP).[40] The Defense Department requested that Dexcel's management be replaced by U.S. instead of Japanese citizens. Rather than comply, Kyocera's Japanese executives all resigned and the firm was sold to a U.S.-owned company.

Nippon Steel-Special Metals. The April 1983 proposed acquisition of Special Metals Corp. by Japan-based Nippon Steel Corp. set off alarms at the Defense Department's Industrial Security Bureau (Madison, 1983, p. 1595). Special Metals Corp. manufactured special alloys used mainly in aircraft engines and turbines for power generation. Perhaps more significantly, Special Metals performed work for the Defense Advanced Research Projects Agency, an arm of the Defense Department that oversees government and civilian military research, and was involved in production of alloys for F-15 and F-16 fighter plane engines. Although the Japanese had purchased F-15's and had access to the technology used in the plane's design, Defense Department officials were concerned that the Japanese purchase of Special Metals would a route for critical technology to reach the Soviets--even though the alloy production technology itself was not classified. However, Special Metals was also engaged in classified work for the Defense Advanced Research Projects Agency.

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[40]Authorized by Executive Order 10865, DISP allows the Defense Department to deny a facility security clearance to a foreign-owned defense contractor, if certain conditions are not met (General Accounting Office, October 7, 1977, pp. 8-13).

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Export control regulations and industrial security clearance procedures could have been brought to bear in the Nippon Steel-Special Metals case. But the Defense Department felt that applying technology export restraints or even the retention of U.S. managers would not prevent Nippon Steel's scientists from acquiring sensitive knowledge. Also, Nippon Steel expressed opposition to the installation of U.S. managers because it was not interested in an arms-length subsidiary. Nippon indicated that it was seeking technical knowledge in the deal for "developing new applications for superalloys and in creating innovations in technology" (Ibid).

In mid-May, the Defense Department asked the Committee on Foreign Investment in the U.S. to review the transaction, but by the time CFIUS decided that the national security issues were beyond its scope, there was little time left before the June 30th sale date. Defense officials felt that legal grounds for blocking the sale were lacking. As a result, Assistant Defense Secretary Richard Perle requested that the export control regulations be administratively amended to apply to sales of companies to foreigners, not just sensitive exports of products or technology. However, the Commerce and State Departments nixed this idea. With only 48 hours to go before the sale was finalized, Fred Ikle, the Defense Undersecretary for Policy, met with executives of the parties involved in the transaction. Apparently, Nippon Steel was told that it was not trusted to "protect sensitive material from leaking to the Eastern bloc" (Ibid). When the Japanese realized how controversial the transaction had become, they decided to pull out of the deal. However, the incident left rumblings within the Administration about the lack of powers to block a sensitive sale. One Administration official said, "I don't see how we could have stopped it" if the companies had not called off the deal (Ibid).

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Minebea-New Hampshire Ball Bearings. 1984 found the Defense Department investigating the proposed sale of New Hampshire-based New Hampshire Ball Bearings, Inc. to Japan-based Minebea Corporation (Washington Post, July 24, 1984, p. D13). The sale raised concerns for two primary reasons. New Hampshire Ball Bearings was one of only five firms supplying precision ball bearings to the U.S. military, and two of these were already foreign-owned (United Press International, September 26, 1984). Also, the Defense Department was concerned that New Hampshire's "state-of-the-art technology" would fall into foreign hands (Ibid). Richard Donnelly, Director of Industrial Resources for the Defense Department, testified at a Senate subcommittee hearing on the department's concerns (Hearing, September 26, 1984, p. 9):

> The DOD [Defense Department] considers precision ball bearings--30 millimeter and smaller--such as those produced by NHBB [New Hampshire Ball Bearings] as critical items required to support national defense. Over the last decade DOD has required that all precision bearings--30 millimeter and smaller--procured by defense...be of domestic origin.
>
> Currently, we have five producers for these bearings [and one is already owned by Minebea]...
>
> DOD became involved in review of the planned acquisition of NHBB by the Minebea Co., Ltd. of Japan because of our concern that a viable industrial base is maintained for these products.
>
> ...NHBB uses very sophisticated automatic measuring equipment....As such, it provides advanced capability in the United States for production of precision bearings.
>
> It is important...that in any future industry restructuring this

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> capability be preserved. We are continuing to gather supply and demand data...from Government and industry sources in order to obtain a complete picture of this important industry sector.

Donnelly testified that a CFIUS review had been requested.

In an October 12, 1984 letter to Mr. Donnelly, Theodore Kanell, President of New Hampshire Ball Bearings, indicated that Minebea had given him a written commitment to retain production in New Hampshire and provide a cash infusion of $10-50 million, without which New Hampshire Ball Bearings would be forced to adjust out of bearing production (Ibid). Kanell cited increasing import competition, presumably from companies such as Minebea, as the reason for the proposed merger. Later that month, Kanell also said that he had a written commitment from Minebea to retain New Hampshire's board of directors and management, including Kanell as president (Richey, 1984, p. 6).

A February 1985 Commerce Department report said the following with respect to the Minebea-New Hampshire Ball Bearings deal (Commerce Department, February 1985, p. 60):

> Should Minebea achieve success in its attempt to purchase New Hampshire Ball Bearings, Inc., Japanese companies would have a dominant position in the U.S. miniature and precision bearing industry.

Nonetheless, legal obstacles to the sale were removed when the Justice Department ruled in late February that the deal would not pose antitrust problems (United Press International, February 27, 1985).

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CFIUS formally ended its review process with no objections to the sale the following month (Hearing, May 8, 1986, p. 142).

Fujitsu-Fairchild Semiconductor. On October 23, 1986, Japanese computer maker Fujitsu Ltd. announced plans to purchase 80 percent of a financially ailing U.S. semiconductor maker (Chira, 1986, p. 32). The semiconductor manufacturer, Fairchild Semiconductor Corporation, had been previously bought in 1979 by Schlumberger Ltd. of France (New York Times, October 27, 1986, p. 22). On November 9th, Administration officials announced that the proposed sale would be reviewed by CFIUS because it "could result in the dominance of Japan as a supplier of computer chips to the Pentagon" (New York Times, November 10, 1986, p. 28). Although the company was already foreign-owned, Administration officials indicated that they were not concerned about French involvement with the company because France does not competitively threaten U.S. high technology products (Ibid).

Fujitsu had reportedly been hurt by the recently concluded semiconductor agreement between the U.S. and Japan, which had the effect of setting Fujitsu's semiconductor prices higher than some of its competitors (Chira, op. cit.). According to private industry analysts, this and the strong yen were responsible for Fujitsu's decision to manufacture in the U.S. (Ibid). In fact, amidst charges of gray market dumping and evasion of the semiconductor agreement, other Japanese semiconductor makers were beefing up or planning to begin semiconductor manufacturing in the U.S., including NEC, Toshiba, Hitachi, and Mitsubishi Electric (Schlender and Yoder, 1987, p. 1). One Commerce Department Undersecretary, Bruce Smart said, "We now see an effort by the Japanese to acquire small companies that have been

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woulded by dumping so they can acquire technology without the initial costs" (Ibid).

Concern about the implications of such investments coincided with recent reports by the Defense Department and the Central Intelligence Agency (CIA) that Japan was becoming the dominant producer of microchips. With regard to semiconductors, the CIA told a Defense science review panel in early 1986 (Pollack, January 5, 1987, p. 1):

> This is not another case of citrus, tobacco, or past....The consequences of losing a strong indigenous technology base in this industry could have, in our judgement, widespread effects on this country's ability to maintain technical superiority in advanced weapon systems....

Fairchild is one of two major U.S. producers of high speed emitter-coupled logic chips, widely used in weapons systems and high speed computers (Pollack, January 1, 1987, p. 25). Fairchild's annual sales of military products are in the $150-200 million range (Sanger, 1987, p. 1). The Defense Department has also been reportedly concerned that with a Fujitsu purchase, such chips could find their way more easily to the Soviet Union. Many semiconductor industry executives have voiced concern about the fairness of Japanese firms buying up ailing American semiconductor companies after years of unfair trade practices (Pollack, January 1, 1987, p. 25). Concerns have also been expressed about the marketing and distribution network that Fujitsu would tap into with the Fairchild purchase.

In March 1987, Commerce Secretary Malcolm Baldrige told the press that he and Defense Secretary Weinberger had asked the

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Administration to block the Fujitsu-Fairchild linkup, indicating that they had the support of the CIA in their views (Kilborn, March 12, 1987, p. 29). A senior official who asked not to be named said, "This is a test case. If Japan can come in and buy this company, it can come in and buy them all over the place. We don't want to see the semiconductor industry under Japanese control" (Ibid). In a fairly unusual move, indicating the degree of Administration sensitivity to the proposed acquisition, government officials indicated that the investment would be reviewed by the Economic Policy Council, consisting of White House and Cabinet officials involved in economic issues. Within days of the announcement by Secretary Baldrige, Schlumberger scrubbed the sale of Fairchild (Sanger, 1987, p. 1; Wilson and Dryden, 1987, p. 28). Confusing the issue were reports that Administration pressure had as much to do with semiconductor pact violations by the Japanese and trade frictions as to do with national security concerns (Sanger, op. cit.)

Significantly, there was little legal basis for preventing the sale. At the time of the cancellation, the Fujitsu-Fairchild linkup was being studied by the Justice Department for antitrust implications (Schlender, March 13, 1987, p. 4). However, it was not expected that this would provide a basis for blocking the sale.

5.6 Shifting Policy: An Unclear Future for FDIUS

President Reagan's announced policy on foreign direct investment in 1983 was basically a restatement of the official FDIUS policy doctrine of preceding administrations--"the open door"--a basically neutral stance. However, significant departures from preceding policy occurred as the Administration developed, early on, a deep concern

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about the implications of foreign-owned investment in the United States. The concern was particularly made acute by the election of Mitterand's Socialist government in France and subsequent nationalizations of major French multinationals in 1982.

Nonetheless, while increased review of investments took place within the Committee on Foreign Investment in the United States (CFIUS)--compared to the Ford and Carter administrations--investments were rather perfunctorily approved by the review panel. An increasing concern about technology-related national security issues became apparent beginning about 1983. Significantly, the highly publicized cases all involved Japanese investors, fears of increasing Japanese industrial dominance or market share in industries whose output was significant to weapons-systems production. In the case of Fairchild, trade friction also manifested itself as an issue.

To the extent that any of the above-mentioned cases reflects a movement in U.S. policy on FDIUS, we could be witnessing in the Reagan Administration a significant abandonment of the principle of "national treatment." Fairchild's ownership by a French concern posed no problems, yet potential ownership by a Japanese concern did. Dexcel's ownership by a Japanese outfit became of concern to Defense Department officials. Would the same have been true if Dexcel had been a British or French-owned company? If Minebea had been a Canadian firm, would the Defense Department have raised its eyebrows over increasing Canadian competition within the ball bearing industry? Probably not.

What is actually reflected in these cases, and this is especially

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highlighted by the Fujitsu-Fairchild case, is that policymakers in the Administration are becoming increasingly uncomfortable with Japanese technology gains. As such, we are likely to see increased Japanese-U.S. investment frictions, especially in high technology industries that have been battered by Japanese competition. Indeed, prompted by concern over the Fujitsu-Fairchild merger, Commerce Secretary Baldrige indicated in March that it was time for fixed investment guidelines to replace the official "open investment policy" (Kilborn, March 18, 1987, p. 25).

5.7 Policy Failure

A significant policy failure, regardless of Administrations, has been a general failure to examine the economic consequences of investments. This is not to say that economists have not played a role in formulating U.S. policy. Rather, a single-minded obsession with the concept of free movement of factors--in this case, international capital--within the international marketplace has obliterated attempts to collect more meaningful data. This obsession has not been a naive one. Government officials are profoundly aware that U.S. direct investment abroad (USDIA) is much greater than foreign direct investment in the U.S. (FDIUS). However, they do not seem to be cognizant of the fact that, in recent years, the growth of FDIUS has far outweighed that of USDIA. The implications of this have not been fully explored.

FDIUS has been described as providing important stimulation to local economies through added jobs and spinoff linkages. Yet, these notions may be unfounded. Although an attempt has been made here to demonstrate the plausibility that foreign-owned firms are not contributing to job creation, at best, the attempt fails for lack of

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appropriate data. Data that the Bureau of Economic Analysis either does not collect, or does not publish. Although an exploration of foreign-firm linkages in comparison with domestic-firm linkages has been attempted here, the effort largely fails for lack of sufficient data. The Bureau of Economic Analysis could go a long way to improving such an analysis by increasing the level of disaggregation of data on foreign-firm imports and exports, as well as updating more frequently the input-output tables for the United States.

As we have seen in the case of the auto industry--and it has occurred in other industries as well--FDIUS responds to trade policy. If trade and investment policy are not coordinated, the result of one can be the defeat of the other. Negotiation of the auto-import V.R.A. was premised on obtaining industry relief. Rather, what we have seen is continued erosion of the traditional U.S. industry and increased import of partially assembled autos and auto parts, with many of the same consequences for the domestic auto industry: job loss, plant closings, and damage to linked industries. Furthermore, it is not clear that any "true" technology transfer has been effected to domestic producers from foreign-based.

Lastly, U.S. policy has been so concerned with protecting USDIA from retaliation by allowing virtually unregulated foreign direct investments, that almost all other questions have been overlooked, with the recent exception of national security issues narrowly focused on Japan's increasing technological preeminence.

Clearly, there is a national interest issue at stake in more fully exploring the impact of FDIUS.

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Chapter 6

Some Thoughts On the Implications of FDIUS

A paucity of data for appropriate analysis makes it difficult to assess the imlications of foreign direct investment in the U.S. (FDIUS). In large part, this is a reflection of federal policymaker's wishes to avoid discouraging FDIUS by overburdening such investors with reporting requirements and risking possible disclosure of operating data which might hinder a firm's competitiveness. Nonetheless, the available data suggest that foreign-owned firms in the United States may not play the same role in job creation and the stimulation of economic linkages that domestic-owned firms do. This provides ample fodder for seeking additional data with which to pursue the analysis which might definitively characterize the impacts of FDIUS.

Foreign direct investors are apparently, as discussed, neither necessarily attracted to the same industries nor regions as domestic investors. By itself, this says nothing. But, taken in the context of overall industrial restructuring and regional shifts, such differences may prove of importance to economic developers. Furthermore, while the data indicate that jobs attributable to foreign direct investors have been increasing dramatically, it is clear that such employment is not rising as a consequence of tremendous job creation. Rather, thousands of

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Americans are finding that the firms and businesses that they work in are being sold to foreign interests. Comparatively little FDIUS employment growth may be attributable to the start-up of new businesses. Is there any significance to this? Maybe. It is apparent that the high volume of foreign acquisitions has been accompanied by significant restructuring or actual layoffs of employees--and such restructuring and layoffs may be occuring at a substantial level of magnitude in the regions which have been hurt worst by domestic-firm restructuring and layoffs. It is not clear what the beneficial impact, if any, of foreign direct investment has been to U.S. regions and industries.

A variety of evidence points to the import-propensity of foreign-owned firms. Such evidence lends credence to the belief that foreign direct investment may be accompanied by significantly less local linkages than is domestic investment. A survey of Texas manufacturing firms has attempted to provide some new light on this question. While the survey results do not suggest tremendous differences in the immediate linkages produced by foreign-owned firms in contrast to domestic-owned firms, inadequacies in the survey design or response may account for the lack of differences found. As well, a significant failing of the survey is that by examining only immediate, first-order linkages, a great deal of the truly significant information bearing on the question is ignored. In the end, we can only conclude that more work needs to be done in this area before meaningful conclusions are drawn.

A review of foreign trade and investment-related penetration of the U.S. auto industry suggests the intertwined nature of trade and investment policy. Also, the review suggests that foreign direct investment in this industry has been accompanied by massive economic

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dislocation, accompanied by few obvious spinoffs or benefits to technology, management, and workers in the industry. While the circumstances of the U.S. auto industry are unique in many respects, in many ways they are not. The role played by foreign direct investment in the restructuring of this industry may prove instructive for other industries, as well.

Examining Federal policy in recent years, one finds an almost total failure to examine or question the economic consequences and impacts of foreign direct investment. While the reasons for this failure are clear enough, and make for an interesting story, the failure itself raises questions about the Federal government's ability or willingness to assert a meaningful role in the operation of the nations' economy. This is nothing new, of course. What is significant is that this failure may take on added significance when increasingly, the major players in the economy--businesses--are no longer owned or controlled by U.S.-based interests.

Much work remains to be done in examining FDIUS, and many more questions need to be answered. While the approach taken here has shed a little light on some of these questions, it is hoped that this analysis illustrates the inadequacies of available information as well as the special sensitivity of the economy to traits which may be characteristic of foreign direct investors. Hopefully, this work will be followed by attempts to seek more information and provide more detailed, in-depth analysis of the behavior and impacts of foreign direct investors.

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Appendix A.

The Calculation of Some Formulas Used Chapter 2

A.1 Location Quotients

The "location quotient" is a ratio of employment shares of foreign direct investors in a given region to the total U.S. nonagricultural share of employment in the region. The calculation for the location quotient, $l^i_{foreign}$, for industry, i, is as follows:

$$l^i_{foreign} = \frac{e^i_{foreign}}{\sum_{i=1}^{9} e^i_{foreign}} \times \frac{e^i_{U.S.}}{\sum_{i=1}^{9} e^i_{U.S.}}$$

Where:

$e_{foreign}$ = FDIUS employment in a region,
$\sum_{i=1}^{9} e^i_{foreign}$ = All FDIUS employment,
$e_{U.S.}$ = Domestic U.S. employment in region,
$\sum_{i=1}^{9} e^i_{U.S.}$ = All Domestic U.S. employment.

When the location quotient is equal to one, the share of FDIUS employment in a region is the same as the share of U.S. employment in

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the region. If the location quotient is greater than one, the share of foreign-owned firm employment in the region is greater than the share of U.S. employment--in other words, foreign firm employment is relatively more concentrated in the region than U.S. employment. If the location quotient is less than one, the converse is true, and foreign firm employment is relatively less concentrated in the region than U.S. employment.

A.2 Concentration Ratios

This "concentration ratio" is very much in concept like the location quotient (discussed earlier). Instead of region shares of a type of activity, we are interested in industry shares of activity--the activity being in this case being the number of acquisition transactions rather than employment. The general formulation of the concentration ratio, $c^i_{foreign}$, for industry, i, is as follows:

$$c^i_{foreign} = \frac{n^i_{foreign}}{\sum_{i=1}^{9} n^i_{foreign}} \times \frac{n^i_{U.S.}}{\sum_{i=1}^{9} n^i_{U.S.}}$$

Where:

$n_{foreign}$ = FDIUS acquisitions in an industry,
$\sum_{i=1}^{9} n^i_{foreign}$ = All FDIUS acquisitions,
$n_{U.S.}$ = Domestic industry acquisitions,
$\sum_{i=1}^{9} n^i_{U.S.}$ = All Domestic acquisitions.

When the concentration ratio is equal to one, the share of all

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FDIUS acquisitions in an industry is the same as the share of all domestic-source acquisitions in the industry. If the concentration ratio is greater than one, the share of foreign-buyer acquisitions in the industry is greater than the share of domestic acquisitions--in other words, acquisitions involving foreign buyers are relatively more concentrated in the industry than those involving domestic buyers. If the concentration ratio is less than one, the converse is true, and foreign firm acquisitions are relatively less concentrated in the industry than are domestic-source acquisitions.[41]

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[41]This concept of the concentration ratio could as easily be based on employment as numbers of transactions.

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Appendix B.

Sampling Sources and Methodology for Survey Discussed in Chapter 3

A number of sources were used to identify the Texas foreign firm sample. In fact, in attempting to identify every foreign firm possible, it was hoped that the actual population of Texas foreign manufacturing firms could be approximated as closely as possible. The primary source of information on foreign direct investors in Texas manufacturing was Arpan's and Rick's Directory of Foreign Manufacturers in the United States (1985). The Arpan's and Rick's directory was convenient because it listed foreign firms by state, providing names and addresses of firms, as well as the primary 4-digit SIC in which the firm was operating. The Arpan's and Ricks's directory was supplemented with several other sources, including:

Directory of Foreign Firms Operating in the United States, 5th Edition, World Trade Academy Press, New York, 1986.

American Subsidiaries of German Firms, 15th Edition, Deutsch-Amerikansche Handelskammer, New York-Bonn, 1983.

Japanese Overseas Investment: A Complete Listing of

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Firms and Countries, Toyo Keizai Shinposa, Tokyo, 1984.

MacKnight, Susan, Japan's Expanding Manufacturing Presence in the United States: A Profile, Japan Economic Institute of America, Washington, D.C., 1981.

Japan's Expanding Manufacturing Presence in the United States: 1985 Update, Japan Economic Institute, Washington, D.C., 1986.

Foreign Direct Investment Transactions in the United States, 1974-1983, Data Obtained on Tape from the International Trade Administration, U.S. Department of Commerce.

Foreign Direct Investment in the United States, 1984 Transactions, International Trade Administration, U.S. Department of Commerce, September 1985.

Foreign Direct Investment in the United States, 1985 Transactions, International Trade Administration, U.S. Department of Commerce, September 1986.

Some of the sources provided descriptions of the industry in which a firm operated rather than a specific SIC. In these cases, an SIC was assigned based on the industry descriptions in the Standard Industrial Classification Manual, published by the U.S. Office of Management and Budget (1972). The latter five sources failed to provide establishment addresses. Each of these establishments was checked against the 1986 Directory of Texas Manufacturers, published by U.T.'s Bureau of Business Research (1986). Where a match was found to have a corresponding address, the firm was included in the foreign

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firm sample. The 1986 Directory of Texas Manufacturers was also used to obtain additional data types for as much of the sample as possible, including employment size class, verification of SIC's, and telephone numbers.

The 1986 Directory of Texas Manufacturers also provided the source for the identification of the domestic firm sample. The assumption was made that any firm not identified previously as foreign-owned was domestic-owned. In addition, suspect firms were checked (firms with foreign-sounding or unusual names) against a file of foreign-owned firm names taken from the Commerce Department data on tape. The sample of domestic firms was not a simple random sample. Rather, a random sample of firms was taken, stratified by 4-digit SIC and employment size class. Because size class was not available for all of the foreign-firm sample, those for which size class was available were treated as certainty units. In other words, If four foreign firms in SIC 2443 were in the sample, one of size class "1", another of size class "4", and two of unknown size class, two domestic firm units were "certainty selected", one of size class "1" and the other of size class "4", and both of SIC 2443. The remaining two domestic firm units for SIC 2443 were randomly selected without consideration of size class, since it was unknown for a similar portion of the foreign firm sample.

The survey was conducted by mail. A survey instrument was mailed to each identified sample unit with an explanatory cover letter and a postage-paid business reply envelope. The survey instrument is attached as Figure B-1.[42]

[42]The cover letter and business reply envelopes were graciously provided by U.T. Austin's Bureau of Business Research.

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Figure B-1: The Survey Instrument

Texas Manufacturing Survey

F300

Name of Firm_____ [redacted] CORP.
Address_____ ATTN: PLANT OR SITE MANAGER
(Please fill in above if different than on printed label.) PO BOX [redacted] [redacted] INDUSTRIAL PARK
Your Name/Title_____ [redacted] TX [redacted]
Phone_____

Instructions: Please answer each of the following questions by checking the appropriate category or filling in the requested information. (If for some reason you feel that this information may not be divulged, please complete as much of the survey as possible.) Then return this survey in the enclosed business reply envelope or mail it to the following address by January 23:

Dr. James F. Smith
Bureau of Business Research
The University of Texas at Austin
P. O. Box 7459
Austin, Texas 78713

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1. Does your firm's present line of business at this location involve manufacturing? _____Yes _____ No

   If no, does your firm have another location in Texas at which manufacturing activity takes place? _____Yes _____ No (If yes, please answer the survey for that location or forward the survey to that location. Also, please indicate the address in the space given above. If no, please stop and return this questionnaire.)

2. What percentage of your firm's total purchases or transfers of material goods for this location are made from other businesses (or any other units of your firm) located in:

   _____(%) Texas _____(%) Other States Bordering or Adjacent to Texas
   _____(%) United States (including those areas checked above, but not foreign countries)

   (Please enter a value for each. If it is not possible to give a precise figure, please estimate.)

3. What percentage of your firm's total sales or transfers of material goods from this location are made to other businesses (or any other units of your firm) located in:

   _____(%) Texas _____(%) Other States Bordering or Adjacent to Texas
   _____(%) United States (including areas checked above, but not foreign countries)

   (Please enter a value for each. If it is not possible to give a precise figure, please estimate.)

4. Which best describes the kinds of materials or inputs purchased by your firm for manufacturing production (please check one)?

   _____Crude or unprocessed materials
   _____Materials or goods that have been partially processed but require further processing

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Figure B-1 Continued

5. Which best describes the products produced by your firm (please check one)?

_____Materials or goods that have been partially processed but require further processing

_____Materials or goods that do not need further processing and are ready for final use

6. Was your firm's physical plant or manufacturing facility (at this location) constructed by the present owners of your firm or acquired from the previous owners of this or another firm?

Constructed _____Yes _____No If yes, what year?_____
Acquired _____Yes _____No If yes, what year?_____

7. Which category best describes the number of workers employed at this location during your peak, or busiest, manufacturing month?

_____[1] under 8
_____[2] 8 to 24
_____[3] 25 to 49
_____[4] 50 to 99
_____[5] 100 to 249
_____[6] 250 to 499
_____[7] 500 to 999
_____[8] 1,000 to 4,999
_____[9] 5,000 or more

8. Which category best describes the type(s) of product(s) manufactured at this location (check more than one if applicable)?

_____(20) Food Products
_____(21) Tobacco Products
_____(22) Textile Mill Products
_____(23) Apparel and other Finished Prods. Made from Fabrics
_____(24) Lumber and Wood Prods. exc. Furniture
_____(25) Furniture & Fixtures
_____(26) Paper, Cardboard, & Pulp Mill Products
_____(27) Printing & Publishing
_____(28) Chemicals
_____(29) Petroleum, Asphalt, & Coal Products
_____(30) Rubber & Plastics
_____(31) Leather Products
_____(32) Stone, Clay, Glass, Concrete
_____(33) Primary Metals from Foundries, Mills, and other Processes
_____(34) Fabricated Metal products except Machinery & Transportation Equip.
_____(35) Non-electrical Machinery
_____(36) Electrical Machinery & Electronics
_____(37) Transportation Equipment, Vehicles, and Parts
_____(38) Instruments & Precision Equipment
_____(39) Miscellaneous

If you checked items 34, 35, 38, or 39, or none of the above categories best describes your firms product(s), please describe in your own words_____
_____
_____

9. Does your firm have more than one manufacturing plant? _____Yes _____ No

If yes, please check the area(s) in which other plants are located:

_____Texas
_____Other U.S. Location
_____A State Bordering or Adjacent to Texas
_____Foreign Location

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Appendix C.

A Summary of Restrictions On Foreign Direct Investment in the United States

The following is a list of federal and state restrictions on foreign direct investment in the U.S., compiled in 1983 by Harvey E. Bale, Jr., Assistant United States Trade Representative for Investment Policy (Bale, 1983, pp. 45-46). As such, "restriction" signifies a departure from "national treatment," or the policy of treating foreign and domestic investors alike, irrespective of nationality. Bale notes that many of the restrictions amount to very little in practical terms, since statutory requirements can often be met by simply incorporating in the U.S. Sometimes, the statute merely authorizes federal agencies to restrict foreign investment, without requiring that they do so.

1. **Air Transporation.** Foreign acquisitions and provision of certain air services by foreign investors require CAB approval. U.S. air carriers must be U.S. citizens. *49 U.S.C. Secs. 1351 et seq., 1372, 1278, 1401, 1508(b.)*

2. **Ocean and Coastal Shipping.** Operators and those seeking government benefits must meet certain U.S. citizenship requirements. *U.S.C. Secs. 11, 221, 251, 292, 316, 319, 802, 808, 883, 992, 1132, 1151 et seq., 1160, 1171 et seq., 1177, 1241, 1241-1, 1271 et seq., 1281 et seq., 1401, 1531; 50 U.S.C. App. Secs. 1737, 1746.*

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3. **Banking.** Federally chartered banks must have a majority of U.S. citizens on their boards. *12 U.S.C Sec. 72.* Some states also restrict foreign-owned banks.

4. **Insurance.** Some states impose special requirements on foreign-owned insurance operations.

5. **Access to Classified Information.** Absent an applicable treaty, foreign firms may be unable to obtain the security clearances necessary to perform certain government contracts. *Executive Orders 10865, 12064.*

6. **Government Insurance and Loan Programs.** Overseas investment insurance programs, agricultural emergency loans, and loan guarantees for electric vehicles are subject to certain U.S. citizenship requirements. *7 U.S.C. Secs. 1922, 1941; 15 U.S.C. Sec. 2509; 22 U.S.C. Sec. 2198(c*; 46 U.S.C. Sec. 802.)

7. **Energy and Power Production.** Foreign investors may generally not receive licenses to own or use nuclear materials and facilities. *42 U.S.C. Secs. 2133, 2134.* Leases and licenses for geothermal power, ocean thermal energy conversion facilities and hydroelectric power facilities require domestic incorporation. *16 U.S.C. Sec. 791; 30 U.S.C. Sec. 1015; 42 U.S.C. Secs. 9101 et seq.; 46 U.S.C. Secs. 1271-1279.*

8. **Mineral Resources.** Exploitation of certain federal lands requires domestic incorporation and reciprocity. *30 U.S.C. Secs. 181, 185(a*; 43 U.S.C. Secs. 1651 et seq.; 43 U.S.C. Sec. 2009.) Some states also restrict access of foreign investors to mineral resources on state land.

9. **Fishing.** Foreign flag vessels are subject to certain restrictions. *16 U.S.C. Secs. 1801 et seq.; 46 U.S.C. Sec. 251.* Special governmental assistance is limited to U.S. citizens. *46 U.S.C. Secs. 802, 1177 et seq., 1271 et seq.*

10. **Customhouse Brokers.** Licenses are limited to U.S. citizens. *19 U.S.C. Sec. 1641.*

11. **Ownership of Real Estate.** Publicly-owned lands may not be sold to non-U.S. citizens or non-U.S. corporations. *43*

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U.S.C. Sec. 1717. Foreign holders of agricultural land must report their ownership. *7 U.S.C. Secs. 3501-3508.* Also, foreign investors must report their holdings or real property to the Internal Revenue Service. *26 U.S.C. Secs. 861, 871, 882, 897, 6039 C, 6652.* About thirty states control foreign ownership of land in some fashion.

12. **Radio and Television Broadcasting.** Neither foreign governments, foreign enterprises, nor (if the Federal Communications Commission makes a public interest determination) foreign-controlled domestic corporations may hold common carrier licenses. *47 U.S.C. Sec. 310.*

13. **Submarine Cable Service.** The Federal Communications Commission is authorized to deny licenses to foreigners. *47 U.S.C. Secs. 34, 35.*

14. **Communications Satellite Corporation.** Foreigners may own no more than 20 percent of the shares of Comsat. *47 U.S.C. Sec. 734(d.)*

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